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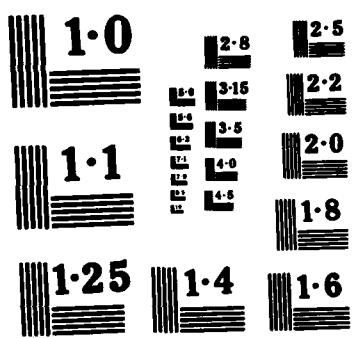
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**1984 DEFENSE FINANCIAL AND  
INVESTMENT REVIEW (DFAIR)****SURVEY OF DEFENSE  
PROCUREMENT PERSONNEL  
NARRATIVE COMMENTS****DECEMBER 1984**Appendix 4, Part 2**DTIC FILE COPY**

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INVESTMENT REVIEW (DFAIR)**

**SURVEY OF DEFENSE  
PROCUREMENT PERSONNEL  
NARRATIVE COMMENTS**

**DECEMBER 1984**

Appendix 4, Part 2

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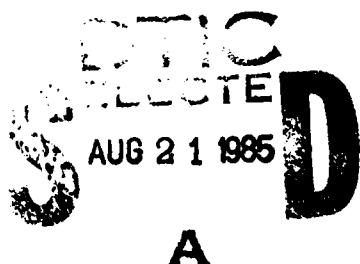
PUBLIC RELEASE

1984 Defense Financial and Investment Review (DFAIR)

Survey of Defense Procurement Personnel

Narrative Comments

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December 1984

PUBLIC RELEASE

This report was prepared for the Defense Financial and Investment Review (DFAIR) Study Group under the auspices of the Deputy Under Secretary of Defense (Acquisition Management). Interpretations and viewpoints contained in this report do not necessarily represent the official position of the Department of Defense or the DFAIR Study Group.

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## SECTION I

### Introduction

On December 2, 1983 the Deputy Secretary of Defense directed that a formal, full-scale study be performed with a goal of recommending improvements to Department of Defense (DoD) contract pricing, financing, and profit policies. The impetus for this directive was Executive Order 12352, "Federal Procurement Reforms," signed by President Ronald W. Reagan on March 17, 1982, that required the reform of federal procurement practices to insure effective and efficient spending of public funds.

The Deputy Secretary of Defense directed that the study be conducted by the Deputy Under Secretary of Defense (Acquisition Management). A steering group and a study group were formed to execute the study. The steering group was composed of a flag rank officer from each of the Military Services and the Defense Logistics Agency and a member of the Senior Executive Service from the Office of the Assistant Secretary of Defense (Comptroller) and the Defense Contract Audit Agency. This group had overall responsibility for the scope of the study and the formulation of policy recommendations. The study group was composed of individuals from each Military Department, the Defense Logistics Agency, and the Defense Contract Audit Agency. The Director of the study group was from the Office of the Under Secretary of Defense (Acquisition Management). This group was responsible for performing research and collecting data to facilitate the development of recommendations for policy improvements to the steering group.

As part of its research, the study group, entitled the Defense Financial and Investment Review (DFAIR) Study Group, requested that the Defense Manpower Data Center (DMDC) conduct a survey of DoD procurement personnel to ascertain their opinions on DoD pricing, profit, contract financing, and investment incentives policies and practices. DMDC has conducted the survey, and the results and findings were published in a separate volume.

The present volume consists of a verbatim transcription of the narrative comments offered by the respondents at the end of the formal questionnaire. Respondents were provided the opportunity to amplify responses to specific questionnaire items or make general remarks. Sections II and III of this volume present these comments. Section II presents comments which were not identified as relating to any specific questionnaire section or item. Section III presents comments which were identified by the respondents as being related to specific questionnaire sections or items.

Following the page in the questionnaire for the comments presented in Sections II and III of this volume was a "Supplementary Survey Question" that dealt with the treatment of risk reduction provisions when pre-negotiation profit objectives are established. Two specific questions were posed and respondents were asked to provide comments if they had a firm opinion on this issue. These comments are presented in Section IV of this volume. Of the total 780 respondents who returned completed questionnaires 186 (23.8 percent) responded to the Supplementary Survey Question.

The members of the DFAIR Study Group have reviewed these responses and categorized them as either positive, neutral, or negative. Accordingly, Section IV consists of three subsections, each containing similar types of responses.

The readers of these comments are urged to read and consider them with caution. The comments are not necessarily an accurate reflection of how most respondents answered specific questionnaire items. Not all respondents provided comments and there may be unknown respondent characteristics which determined whether or not respondents made comments. Finally, the comments section of the questionnaire as well as the Supplementary Survey Question both implied that participation in this portion of the survey was optional.

The reader is advised to evaluate these comments in light of the discussion and data presentation made in the volume containing the results and findings of the survey. To further assist the reader, Appendix A of the present volume contains the survey questionnaire and Appendix B presents the responses to each of the questionnaire items.

SECTION II  
GENERAL COMMENTS

- o As long as profit is calculated as a percent of cost, there is no hope.
- o I don't believe there is sufficient exposure of DoD pricing/contract financing/profit policy outside the DCAA, contract price functional areas. The actual contracting offices neither input nor manipulate these policies and only marginally react to them. Contractors universally express displeasure with Government financing/profit policy. Weighted Guidelines are most often "backed into" or prepared from wild guesses if done in advance rather than thoughtfully prepared and utilized.
- o My name is (name deleted) and can be reached at (number deleted) or (number deleted) and will cooperate on expounding any answers as given by me.
- o Prenegotiation profit and negotiated profit should consider working capital (over and above progress payments) net and invested capital, new equipment required, interest rates, etc., as does commercial profit.

Investment incentives should be tax credits--after purchase, to ensure use of the money for equipment in lieu of corporate profits, dividends, retained earnings to boost book value.

Contract financing should be justified on a case-by-case basis.

Stop the war between contractors and Government. Either trust them more or realize that our association is long-term and mutually advantageous. Stop pressure tactics by higher echelon know nothings.

- o I have not observed any degree of evidence that CAS 414 or any other stated profit policy has had an impact on the contractor's decision to make capital investments which impact production costs. I do see capital investments, but there is not evidence that it is reducing cost or that it was influenced by CAS 414 or the Government profit policy.

My feelings are that what has happened is to increase the contractor's profit dollars for CAS 414 which investment would happen anyway in order to stay current with production methods and be competitive in the industry involved.

Competition is the best innovator to reduce costs by whatever means available, be it capital investment or other means.

- o The weighted guidelines/profit fee objectives are a farce. I have never seen a contract negotiated where the objective was sustained. Weighted Guidelines should be replaced with an ROI analysis.
- o A more liberal policy should be adopted to finance vendor tooling and dual sourcing for subcontractors under major prime contracts. This would create greater initial costs, but greater long-term competition and savings.
- o The prime motivating factor in allowing for facilities capital employed under the weighted guidelines was to increase capital expenditures and reduce product cost. On the majority of contracts I have been exposed to, product cost continues to climb above inflation factors. Facilities capital employed has not reduced product cost.

Progress payments encourage marginal producers to bid on contracts, and in many instances, default requiring untold administrative cost.

When possible, contracts should be F.F.P. without progress payment and paid when acceptance is made. In my opinion, this is by far the best way to obtain a quality product at the lowest possible price.

- o I seldom have negotiated procurement; therefore my area of expertise is not in the subjects addressed in this questionnaire. The answers furnished are not to be considered as expert opinion.
- o Precedent is important in determining profit, especially with sole source contractors and especially when consideration is given to profit made by contractors in commercial market. WGL is helpful to justify our position, but can be completed so many different ways to come up with the desired profit level. The items listed on WGL are useful to consider. Any numerical values are questionable, though. The form is mainly subjective.

Why should contractors invest in capital required for making our obsolete, not state-of-the-art items? Profit level has no resultant effect on the amount of capital investment made by a contractor.

- o Contracting Officers live with the solicitation for months (and in the case of ceiling price award many additional months). This applies mainly to major systems buys. Then, to negotiate, there are DCAA audits, field pricing, should cost studies followed by BCR reports providing positions. Then, following many weeks and months of above reviews by experts in their fields, the command chain reviews take place. These are the reviews by the chain of command overnight experts on the instant case, who look or thumb through the pages of the Business Clearance and suddenly with their all-seeing eyes come up with the all-knowing wisdom set forth a negotiating objective that the contract negotiating is bound by and in many cases finds impossible to live with. Why not simplify the review process and give more weight to the position of the commodity experts, or let the quicky experts negotiate and thus learn where they should be coming from?

- o Lower costs (and lower prices) are a result of:

- (1) Tooling
- (2) Automation
- (3) Technology

Capital facilities investment

This only occurs when there is program stability and plenty of investment capital available.

Investment capital is attracted by good profits and a favorable tax climate. "There is little justification for a corporate income tax."  
Recommend

- (1) Competition and multi-year contracts.
- (2) Emphasis on firm fixed price contracts without regard to pricing or profits.
- (3) Escalation--necessary only during inflationary periods (controlled by the Government).

- o One of the best ways to lower prices and increase competition would be a total overhaul of the "REQUIREMENTS" management in DoD. Use of materials management concepts such as economic order quantity is almost nonexistent by DoD item managers. Procurement is continually forced to buy uneconomical quantities, or to proceed with acquisitions that do not have sufficient lead time to allow most efficient procurement techniques.
- o I am not confident that current pricing, profit, and contract incentive policies are effective in obtaining the most efficient contractor performance, best quality or best price. Nor am I confident that any change in these policies will improve the situation. The contracting officer cannot effectively negotiate a fair and reasonable contract with a contractor who knows that he cannot in practice say "this is not reasonable, we will go back to management and see about cancelling this program".  
  
Only if weapons programs are funded in such a way that there are alternatives, either for the same or similar systems, can contracting officers effectively negotiate with contractors. All of the guidelines, policies, and incentives cannot achieve contractor efficiencies (or quality products) without some threat of loss of business for inefficient performance, excessive cost, or shoddy products.
- o "Project 60" in the 1960's eliminated the Army Procurement districts and transferred the major procurement functions to the major army commands. Contract pricing was one such function that was transferred to this command, resulting in a growth to about 60 current employees in the Contract Pricing Office. During this same period, I have seen the DCAS and plant representative offices continue to develop the same contract pricing capability. When DCAA is included, it appears that

there are now three separate organizations with the capability to perform contract pricing when one organization, or at the most two, should be all that is required. Presently, the audit report from DCAA goes to the DCAS/plant representative office where a review of the DCAA report is made and changes may or may not be made. A pricing report is then issued to the Army command where an additional review is made and changes may or may not be made. Another pricing report is then issued to the procuring office to be used in negotiations.

- o If this is supposed to turnout as an endorsement of CAS 414, then I hope my negative attitude is reflected herein. CFC is a joke, nothing but a supplemental profit line for the contractor. I have yet to see tangible evidence of new facility (plant or machine) resultant from CFC "donations" from the Government. Save us some money, and eliminate this contractor charity.
- o Too often in major acquisition buys for first production hardware the WGL goals are too restrictive and rarely achievable at the contract specialist level. Profit agreements frequently have to be negotiated at a Division Chief level or higher management other than with the contracting officer on the Branch or Team level. For example, a restricted 10% profit on 1st production engineering services for a CPFF contract is usually laughed at by the contractor who politely tells you, the Government negotiator, that they are aware of the ridiculously low factors (particularly .05 for risk) of the WGL and he, the contractor, refuses to accept anything less than 12 or 13%. When you are negotiating sole source to your prime, this puts you, the negotiator in an uncompromising position.
- o CAS 414 has encouraged investment in things other than increased productivity I.P.E. Some contractors have built palatial office buildings full of baubles and gadgets for their white collar people that add nothing to their ability to produce economically or a higher quality product. They got fantastic facilities capital payments and the Government saves no money and receives no discernable benefit.
- o Cost Accounting Standards have caused increased costs to the Government because contractors are required to make this system meet a standard, rather than their normal method of operation. It should be easier for contractors to use the accounting system they find acceptable for their operation. The Government should be able to determine the reasonableness if the records are disclosed without requiring a form-fitted system.
- o The biggest problem in DoD contracting is the fiscal restraints because of the lack of fiscal responsibilities by Congress--continuing resolution is a farce--a cop-out!

Secondly, defense costs are tied into social economic programs--more detrimental towards misconception than fraud, waste and abuse.

Third, prime contractors on missile systems have the potential to compete on any system--the economic impact and Congressional distribution of wealth prohibits reduced costs.

- o I feel this survey should be completed closer to the completion of the course being surveyed.
- o The profit policy needs revamping. Facilities capitalization has been abused by a few contractors who build new parking lots and cafeterias, then get reimbursed cost of money at a high rate and flow the costs to the WGL to justify higher profits. Other contractors ignore the whole thing. You must realize that a sole source Defense contractor is motivated by a lot more than profit. Keeping a high level of engineering expertise to help win future programs is more meaningful than another percent of profit. Now they can invest in quality of life investments and get us to pay for it.
- o Many questions asked were not answerable because of phrasing. Impossible for me to give an answer when question phrased, "if this happened, then that would happen." I have no idea if "that would happen." I could have, however, addressed, theoretically, a question phrased as "that could or should happen."
- o Contractor does not, in spite of DoD methods of encouraging capital investment, use any additional dollars for plant modernization or investment. His constituency is his shareholders and what he is after is more dollars to put out as dividends.
- o Current DoD practices of pricing the profit to the amount of cost thus discouraging increase in productivity or capital investment. Tax laws also discourage capitalization. These policies must be changed and the Industrial Modernization Incentive Program is a step in the right direction.
- o Contracting in the defense market which consists of a small number of large contractors which have very different corporate philosophies and practices makes it very difficult to derive or set down guidelines or policy. Flexibility at the working level when dealing with a specific contractor on a specific requirement as it relates to pricing, profit, financing and investment incentives is crucial to the over-all achievement of a good contract at a fair and reasonable price. These factors can only aid in these efforts if the product being acquired is properly specified, realistically scheduled, and managed appropriately from both administrative and technical perspectives.

The procurement of weapon systems in one year increments, in quantities which vary from day to day, makes all of the above an exercise in futility.

- o Facilities capital investment is a joke! Too many contractors are showing capital investments on labor, material, etc., instead of true capital investments (capital equipment) as it was intended. We need to develop profit policies that are fixed to type of contract (risk) and cost of money (investment capital) and apply the policies expressed as percentages across the board to benefit both large business as well as small business (those with very little capital for investment opportunity).  
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- o In general, I think what has to be, or rather should be considered in profit development is what does the Government need to do to encourage a contractor to maximize efficiency and provide a quality product?
  - (1) Can the contractor make more profit by directing his qualified personnel to other projects? (2) After taxes, what will his actual profit be? (3) We do our best to eliminate all "fat" from the cost and then we tend to minimize profit so that if we succeed and there is a problem beyond his control, natural disaster, subcontractor failure he would be in a loss position. (4) We don't give consideration to production quality, either negative or positive number of failures, timely deliveries, efficiencies that reduce overall cost to the Government.
- o Failure to consider ROI and interest are serious defects in current doctrine. However, factors in current WG remain relevant.

Existing investment incentives are not well targeted to increase productivity.

Current legal and policy doctrine does not provide for systematically evaluating contractor technical and cost performance and using such evaluation as input to source selection for new programs. Contractors respond by emphasizing front end selling at expense of downstream performance.
- o I do not understand why the cover letter accompanying this questionnaire asserts that the survey is anonymous, when a control number permits specific identification of the respondent.
- o The range of Government contracts is extremely broad. Responses which are true for sole source major weapon systems may be entirely false for fixed price IFB's. However, in either case, one thing remains fundamentally true--contractors will spend up to, and only up to, the amount of funds they have budgeted to do the job. DoD pricing policies seem to miss this very basic and very crucial fact--be it fixed price, cost type, an incentive type--be it over or under priced--the end result will be a cost within 5% of the amount originally budgeted.
- o From individual firms, and in general comments made at Government-industry symposia, the subject always comes up as to how better to base profit or fee. But the simple fact is that regardless of the method on which one bases fee-suppliers are interested in raising the profit solely, regardless of method. And this is natural. The relatively risk-free environment that surrounds most DoD procurements is such that I believe the current level of profit is sufficient. If Government would transfer more risk to the contractor (incentives, steeper share lines, etc.) and forced such measures across the board it would be reasonable to have higher profit votes.
- o Recognizing this entire area is "complex"--we (collectively) should strive toward "simplification" in its application where possible.

- o The Government has a built-in conflict between low price and maintaining an industrial base. Too often, management makes a decision on the industrial base issue on an individual contract. I believe that an annual review by the Department Secretary on establishing an industrial base program would lead to program stability. Program stability is the most important factor in lowering overall cost to the Government.
- o I would suggest that this type of questionnaire be sent to contract or finance managers of the top 100 DoD contractors/subcontractors.
- o Profit, financing, etc., regardless of small interactive changes to DoD policy, will not contribute to contractor capital investment, nor his goals to reduce costs nearly as effective as some basic changes in the way DoD does business. Priority #1: Stable programs. Priority #2: Capital investment and financing as major factors in source selections in lieu of emphasis on costs and profit.
- o 15., 33., etc. Are the objectives needed? They affected my responses.
- o Many questions had to be answered in a noncommittal manner since the impact of these questions is both specific to contractors and situational within the overall time and program context.
- o Many of the questions are general without regard for individual cases, i.e., there are no "pat" answers.
- o The greatest stability to contractor capital investment and ultimately lower Government prices and increased quality product is commitment by DoD and Congress to stabilize requirements, make long-term commitments and fully fund programs. The B-1 program is a perfect example of mismanagement by Congress in funding a major program.

The other question not asked about in this questionnaire is: Why do we claim to induce capital investment by FCOM factor in profit WGL with one hand and reduce contractor's input to performance by .7 (Proxmire Edict) with the other hand? Proxmire's Edict was that in spite of PL allowing interest expense on capital investment, will the contractor receive a net profit increase, thereby the insertion of the .7 factor? My recommendation would be to eliminate the .7 factor and create a real inducement to capital investment both equipment and facilities.

- o I have neither the time nor the requisite optimism (that my comments would be influential) to comment.
- o Good techniques exist already; i.e., capital investment incentives, multi-year contracts, Air Force competition initiatives. However, to use any non-standard technique or to compete a requirement that can be justified as a single source is administratively difficult to the point of being impossible. The system could be vastly improved by: (1) Upgrading pricing/estimating capabilities, (2) Delegating pricing/financing/investment incentive authorities at lower levels, and (3) More thorough considerations of these elements in the acquisition planning stage.

- o I don't understand how Congress can increase our workload without a corresponding increase in people. They wanted something done in spare parts and sent people. The same thing applies to other programs. When people are not allocated, such as warranties, most social-economic changes, etc., we only reallocate our time from one job to another.  
  
In addition, we have so many new people that we are having difficulty getting the job done.
- o Please don't make the mistake of assuming that MANTECH/TECHMOD is giving us lower prices and profits. Its primary purpose is to provide a means for bureaucratic empire building. If you provide a defense contractor with a stable sales base over time and a fair ROI, he'll modernize his plant on his own without Government "help".
- o Consideration should be given to allowability of costs, particularly interest. Generally, a contractor realizes a low profit return because of disallowance of costs.
- o Our profit policies and procurement of weapons on an annual, cost based negotiation have seriously impacted industry's motivation to increase any capital investments. As recent as 3-4 years ago, our policy leaders were advocating 11.5-13% profit was good. The problem has been further aggravated by the inflexibility in our "financing" policies. In my opinion, we are at least 5-10 years behind in worrying about profit/financing policies. We need a new influx of policy makers in this arena to work with our current policy makers. Carlucci initiatives were good, but the "system" would not allow them to work.
- o The Congress needs to give major DoD programs enough stability for it to complete development as well as multiple year production awards. Otherwise, all the other techniques to reduce cost and improve productivity are for naught.
- o Too much emphasis is put on beating profits down for the sake of lowering them.

More emphasis needs to be placed on an even distribution of quality, cost control, schedule and other factors of importance to a particular situation.

- o All the areas and techniques alluded to in the questions/statements have miniscule effect on improving productivity (cost) save one: PROGRAM STABILITY. The rest is light rain drops.
- o The Acquisition/Procurement environment is exceedingly complex for DoD unique goods and services. As such, an objective, top down approval should be made of it to include all the constraints and pressures, e.g., Congressional, political, budget, etc., in all of their many and varied interactions, subelements, etc. It seems we are always trying to correct the system by focusing on its subelements one at a time rather than in an integrated, uniformly comprehensible way which generates broad commitment and support.

- o Recommend that you interview field working level people to ascertain what the real world is like and what changes should be made. Items will be brought out that were not in your survey.

However, your survey is a good initial attempt to get at the problems and solutions.
- o Only DoD attempts to analyze profit and capital investment on a contract-by-contract basis. Private industry, i.e., their managers, are rewarded on overall profit gained/increased at the profit center/corporate level. To duplicate this approach within the Government may be impossible; however, much more emphasis should be placed on program profit/investment and not individual contracts within a specific weapon system. This can be done on major systems by guaranteeing a profit or profits (differing by contract type and stage of program--R&D = 5%, development = 7%, manufacturing = 9%, etc.). Then, reducing profit for non-responsiveness to changed conditions, failure to warrant products, unacceptable contract compliance with specifications, less than desired operational performance, etc. In short, a big carrot with an equally large big stick. If this is done, the contractor would know their potential profit (and lost profit) at the outset. If this is done, quality, program stability, investment, competition will improve because DoD has provided a businesslike approach to making the alternative investment in DoD activities--that's where the profit and return on investment would be.
- o In spite of the cost of money provisions in my production contracts, I found tooling costs to be overpriced. This leads me to believe that the contractor feels the FCOM is not an adequate incentive to compensate him for a more conservative tooling estimate. The contractor also feels that his tooling must be improved to continue responding to DoD needs.
- o In my opinion, CAS 414 has had no real impact on decisions as to whether or not contractors would invest in new facilities. They would have made this investment without the impediment of CAS 414. The Government gets bit twice on CAS 414. Once when we add "additional profit/cost" for CAS 414 and again when we pay through depreciation of the assets.

The present WGL encourages contractors to keep costs high because the higher the costs, the higher the profit dollars. Employees are generally overpaid in the Aerospace industry. It does not appear that contractors do not take a sufficiently strong position on establishing salary or benefits paid to their employees, unlike the Government at the present time. All the young capable people are going to work for the contractors, after the Government has trained them, for salaries 40-50% greater than paid by the Government and much lost benefits.

- o For significant capital investment to be incentivized, there must be a direct and clear means of financially rewarding such investment. Both Cost of Money and Capital Employed are too indirect to accomplish this. Rapid depreciation and tax write-offs are more direct.

- o Lower cost of Government acquisition could be realized through increased profit consideration, recognition of interest and investment costs, impact on long-term investment through program stability, more realistic financing (flexible progress payments, advance payments). This would be applicable to sole source procurements as well as increased competition. In my opinion, the lowering industrial base is caused by low profit rates, low ROI, and increased cost of daily business with Government. Our profit/financial policies should be closer tied to industrial techniques. Drop the push for pricing based on intrinsic value unless we expand flexibility in above areas!
- o Most Personnel have very limited experience with contract financing and investment incentive other than standard progress payments.

More competitors eliminates the need for most contractor financing.
- o Since special emphasis has been placed on Government Contracts due to overpricing someone should have the authority to require the contractor to abide by DCAA's recommendation. If Contractor is unwilling to do so, the government should not do business with this Contractor. More unilateral documents should be issued and settled at the courthouse.
- o We spend entirely too much time in getting a solicitation negotiated within the "allotted" time frame cycle 6, 8, etc., or spending the budgeted funds before the end of the fiscal year. Too much emphasis is placed on the total amount of dollars obligated rather than did we buy at a fair and reasonable price. It is also a fact that more savings occur when we go to the contractor's plant to negotiate. Seems we run out of "TDY funds" early in the year. Why not use the funds saved from these negotiations to fund the TDY trips? Then the "Brass" can take all the boondoggle trips they want.
- o Due to "specialization" the answers given on this type survey are most likely biased by experiences peculiar to a particular contractor.
- o As long as the WGL includes a subjective analysis for assigning weights within the range, there will be difficulties in reaching a negotiated settlement on profit. The contractor always wants the largest weight available in the range which the contract officer cannot usually realistically support. It appears a system could be developed with a percentage (fixed) applied to each element with added or deducted percentages for tangible, supportable by fact reasons.

Few contractors I have dealt with are willing to accept more than minimal risk. Again the risk factor in the WGL should be more defined and less subjective, i.e., a fixed percentage with additions and deductions for tangible reasons.
- o Costs/Prices on DoD Contracts are often influenced more by funding practices of the Government than they are by investment/profit/efficiency policies.

When the Contracting Officer out in the ALC gets a production requirement for a weapons system modification program, often the program is locked into a Sole Source requirement by earlier development contracts to the prime manufacturers.

By the time the requirement gets to the Procurement Office normally it is urgent due to earlier delays and an unpriced action is issued to the prime contractor in order that the schedule may be met. The prime then makes his proposal fit the available funds--after over designing the production kits in order to soak up the last dollar available for the program.

- o Assumed questionnaire was dealing with over \$500K situations. Suggest some policies be established for small purchases (less than \$25K) profit.
- o I think the Government should decrease its role as financier (progress payments). We lose more than we stand to gain, and encourage poor or marginal firms to do business with the Government because financing is provided. In my experience, we frequently lose what we have invested and such financing provides no quality or performance incentive.
- o The present DoD policy of paying a contractor based on his cost plus a profit based on a percentage of that cost merely encourages higher costs. Another pricing system is badly needed.
- o I did not answer questions on pages 8, 9, and 10 because I am not directly involved with Contract Financing and Investment Incentive.
- o Profit has not been the cause of the high cost of Defense Contracting. To the contrary, Defense Contractor experience lower profits than their counterparts who deal only within the commercial area. I am speaking here of only sole source or contractors selected by means other than price competition. There are no "real" incentives under our current contracting rules for a Defense Contractor to control costs. Under WGL, one of the poorer ideas to come along, contractors are actually rewarded for cost. The higher the costs, the higher the profit. If, for example, a contractor is diligent and makes an honest effort to reduce, say his overhead. What would we do on the next buy? We would reduce our estimate of that area of cost and thereby reduce his profit. We have thus rewarded a diligent, cost fighter by lowering the amount of profit he could expect to receive on the next buy. We treat each buy as an end in itself. It is not. Also, while this same cost fighter is reducing overhead, he is making himself less competitive for the next source selection where this overhead would be responsible for "selling" the firm to the SSA. We should reward contractors for reducing costs with higher profits. It would result in much reduced overall Defense Contract Costs.
- o My job in the headquarters is such that I do not deal with these subjects. My responses are based on my direct experience in the subject which ended five years ago. Suggest you might wish to disregard my input.

- o I have been negotiating with Primes for almost my entire career (20 years). An area that needs a lot of work is the inflated profit rates that the primes give to their subs. The way it works today, the more profit given to a sub, the more money the prime makes. Let's not forget that most of the DoD dollars are in sole source of follow-on type action--no competition.

I think we should eliminate any subcontract profit dollar from the primes' profit calculation.

This study is a fine idea, but unfortunately, I believe we will waste a lot of effort of good people's time and not change anything. Nothing changed after "Profit '76" and not much more before that.

- o We have a serious overall problem with all industry--maximize short-term gains regardless of long-term impact. We can do very little to counter this, and that's a shame.
- o Overall, I feel that the Cost Basing System is keeping the Contractor's capital investment down. The Contractor is incentivized to keep his cost high in order that his profit (which is a percentage of his cost) remains high. The Contractor will not increase his efficiency through capital investments because his profit on Government Contracts will be lower (his cost would be lower). We must increase his ROR on Government investments in order to make them competitive with his commercial investments. Increased capital investment will also increase the quality of the product.
- o Your survey had me pondering quite a bit. I'm not sure that I provided a very consistent response. I have difficulty in equating DoD policy on pricing, and profit without first setting forth the objectives for which the Government expects to receive for the money it pays. It seems to me that we are not getting the kind of reliable weapon system that is needed and we are paying too much for what we eventually bring into the inventory. Financial policies, including capital investment, are ways of rewarding contractors, and they aren't doing the job.
- o This relates to all sections.

I feel that there is a tremendous waste of effort in the policy area attempting to solve esoteric problems of pricing, profit, contract financing, investment incentive and CAS when the real problems and their solutions lie in increased competition and effective Government control accomplished by competent, well trained, motivated people.

PL 98-72 is a tremendous step in the right direction. It can only be as effective, however, as the people on the front lines working with it and this is where we are coming unglued.

Personnel policies are forcing the loss or non-availability of good people. We don't have and can't get people who can write work statements that are adequate for competitors, who can effectively review and comment on proposals or follow the administration of a contract.

:

The major emphasis is on file staffing. We are graded on it and constantly reviewed for it. At this location approximately 36 signatures are required for every contract action with very little concern for any of the items covered in your survey.

As lone as we maintain the 90% administrative/policy concerns and 10% "in the best interest of the taxpayer" concerns, reviews like this survey are a joke and a waste of time.

Profit is the motivation for investment and quality and efficiency. There should be much more effort expended on costs rather than profit.

Frankly, the competent people out here where the real world exists are either leaving or losing interest. After 26 years of fighting the battles with the weapons provided by the policy makers, I fall in both categories.

- o I think the concept of the current DoD Profit Policy is good. But, the present method of implementing is wrong, especially with respect to CAS 414.

Profit/fee should be based on three things: (1) Investment; (2) Risk; and (3) Difficulty of the task. I think we should always know: (a) What ROI the contractor will get as a result of our negotiated profit; (b) What is the contractor's true cost of capital for both debt and equity capital; and (c) What is the proportion of debt and equity capital in the contractor's capital structure? How does the ROI or ROE on our contracts compare to the contractor's other business lines, divisions, or other firms in the same business line.

If FCCM is to be retained--we should discontinue treating it as a separate cost--we should include it on the WGL as a profit item. I think it's absurd to give the contractor his ROI (profit) and then pay him his cost of capital as well. The contractor's ROI is to be sufficient to cover his cost of capital--any excess ROI is to reward him for his risk, difficulty of task and the expertise he brings to bear in producing our products.

- o I firmly believe that profits based on costs tends to increase contract cost and does not foster efficient performance. Profit should be based on return-on-investment in capital and operating expenses.
- o There is very little you can do in the regulation to accommodate greed on the part of individuals who want to climb the corporate ladder. Corporations and stockholders don't ask if profits have been earned in a moral manner.
- o Grade level is SES-04
- o The primary objective of competition is the establishment of a fair and reasonable price for specified goods (or services). Notwithstanding, secondary considerations such as protection of the industrial base,

equitable distribution of Government business, and the posture benevolent of the Government, a fair and reasonable price is attainable through negotiation(s) without regard to the issue of the size of the source (large or small). The fundamental economic profit motive concept provides sufficient sources with whom to negotiate for goods and services. Given an open and unrestricted public view of Government procurement activities (existing and planned) the market place will decide who produces desired goods and services.

- o A. Response "3 - Neither Agree Nor Disagree" means maybe, but not necessary.

B. Rate of profit negotiated should be based more on contractor's performance in (1) furnishing quality products, (2) reducing product prices, (3) making timely deliveries, etc. Major emphasis of weighted guidelines is contractor's direct input to performance which can be offset by good make/buy change decisions. For example, a contractor can go out and establish/qualify a vendor to provide a major service with the results of higher quality and lower cost. He would be penalized because of the weighting variance between Direct Labor and subcontract/material purchases.
- o Section II and Section III questions on pricing and profit and their impact on efficiency and capital investment.
  - (1) Acknowledging capital investment by CAS 414 and profit on capital employed is not sufficient to encourage improvement in facilities and new acquisition. Companies need long term commitment (e.g., multi-year contracts) to get loans for investment and recover sunk costs.
  - (2) To contractor's management team efficiency means lower profits since reduced cost means reduced fee/profit in total dollars (regardless of percentage).
- o Section III Profit: The Government does not press the favorable financing we provide as customers in negotiation of profit. We provide opportunities private sector customers can't and should receive favorable consideration in lower profit and ROI. Similarly, DoD profit policy should have a sliding scale for profit as a percentage of cost to reflect a cost/quantity relationship. The same relationships do not apply to a \$200,000 contract as compared to \$20,000,000.
- o Weighted guidelines is a tool which too often is taken as gospel. An adroit negotiator can play with the figures and wordsmith rationale in order to please management. Unfortunately, in Government contracting, profit is viewed as an evil. Industries, and their idiosyncrasies should be considered. Highly competitive markets probably would work out okay provided there's a strong commercial market. In ship overhaul and repair, that's not the case. On the other hand, industry has shot itself in the foot numerous times by crying wolf about the mean Government forcing it into the red. Their credibility is diminished when the media report the \$300 hammer cases, etc.

- o Have been in management position for several years. Have not been involved in pricing at any level for approximately nine years.
- o (1) The biggest impediment to capital investment by defense contractors is excessive uncertainty caused by the lack of commitment by the only buyer of the product (i.e., the Government). In the commercial world, this uncertainty is mitigated by the existence of a number of buyers with relatively predictable behavior.  
  
(2) Additions to profit without discreet visibility, such as the productivity improvement and capital investment factors in the Weighted Guidelines, are not taken seriously by contractors during the negotiation process. These items are usually lost in "Bottom Line" discussions of profit/price.
- o (3) The DoD needs to establish some type of value-based pricing concept to avoid: (a) Penalizing contractors by paying less profit when costs are lowered through increased productivity, and (2) Paying for overhead fluctuations caused by business base fluctuations. Value-based negotiations would be simplified by only considering such items as configuration changes, inflation, etc., as applied to an established base price.
- o In the recent past, we have noticed a creeping increase in the profit rates being demanded by the prime. At the same time, however, we have also noticed a greater reluctance to risk assumption and quality of output. Our current method of profit motivation is out moded and ineffective. Need to look at other avenues such as return on investment, etc.
- o I feel the WGL method of determining profit objectives is counter to cost effectiveness. It encourages increased costs and discourages contractor investment into cost saving capital.

In my opinion, the best way to foster contractor capital investment is to use such contracting methods as multi-year contracting which gives the contractors enough long-term confidence in the program to make the investment; technical modification initiatives or industrial modernization agreements that set up an adequate return on investment to encourage contractor capital projects.

If you want more details on my opinions, please call me at (number deleted) (name deleted).

- o My background is in contracting for spares and one large FMS contract. most of the questions here deal with issues performed by our pricing and audit people.
- o I do not believe contractors use the capital investment allowance for what it is intended for.
- o I am sure it is apparent that the type of industry involved would heavily influence how industry reacts to capital investment oriented profit policy; e.g., the garment industry with low labor cost, low

capital investment requirements will react quite differently than the precision bearing industry with high labor and/or high capital investment requirements.

- o Several questions address WGL. Recommend consideration of methods used by other Federal Activities for possible use by DoD. The FAR doesn't mention how GSA, DOE, DHHS, NASA, or any other agencies computer fee.
- o For all practical purposes, the WGL and FCCM formats could be deleted from FAR and one simple matrix covering profit ranges for type of effort and type of contract substituted. Then simply adding a few suggested elements for consideration (capital investment, past performance, state-of-the-art) would suffice for PCO discretion.

By far the most important element for negotiating a reasonable price is the "in-house" Government technical evaluation and no amount of regulations can substitute for this element.

Currently, there exists a myriad of regulations concerning negotiation, the result of which is to draw a contract negotiator's attention to narrow price elements and away from the overall contract being negotiated.

### SECTION III

#### Comments Related to Specific Questionnaire Sections or Items

##### Pricing Policies and Practices (Items 8-16)

###### Questionnaire Item 8 Comments

- o The two biggest problems which never seem to be adequately addressed are: (1) Cost reduction through IMIP type Capital Investment Savings Sharing which could be enhanced by combining with multi-year and more easily obtained waivers for SAIP and other up-front investment (parts-materials) related cash flow contract financing, and (2) Cost reduction through overhead reduction; allowing the contractor a large share of any permanent cost savings resulting in total overhead cost reduction.
- o Small Business program seems to result in awards to marginally qualified contractors due to political pressure.
- o I have found in dealing with several major defense contractors that being efficient is not important, but having a large labor base is more important and I believe results in high cost to the government.
- o DoD pricing policies are gamed by large contractors. Original intention and final results are very different. Process is so complex and complicated only a few understand and most cannot understand what going on. It's getting more and more complex.
- o There is no relation of total contractor compensation to cost, profit, and prices. For example, design-to-cost, performance incentives, etc.
- o The tools that we use can be effective if the data on which we base our input on is realistic, rather just contractor derived.
- o We must find a path away from the cost based profit system. ROI or some acceptable measure of merit.

###### Questionnaire Item 9 Comments

- o The policy may sufficiently consider profit, but in practice, profit is considered an evil.

###### Questionnaire Item 10 Comments

- o Current pricing practices nearly always result in unrealistic positions and forces a Contracting Officer into negotiating both with the contractor and the Government. The end product of the pricing effort cannot be effectively used in determining a negotiating objective.

#### Questionnaire Item 11 Comments

- o Most definitely we move to fixed price contracts too soon--preventing us from getting good, in-depth production cost data which can be invaluable in later negotiations. Also, by the way, the tendency to add CEIS requirements on contractors with fixed price contracts is pointless and will add costs to our contract--costs which get us nothing of any value!
- o The type of contract for a particular weapons system should be as determined by the contractor, not by a DARCOM "3 star" redirection.
- o Contract type is often politically determined at levels above the buying office. When done at working level, it is usually determined in a subjective manner, not as a result of a rigorous analysis of cost risk.
- o For weapons acquisitions which involve exotic metals and are long lead either because of production or material should be redeterminable. Recently, we were directed to firm fixed price which gives more risk to the contractor and also more risk to the Government that the item is overpriced due to projections of material and labor escalations.
- o The DAR/FAR does not encourage creative use of either mixtures of, or other hybrid features of contract types. Labeling of contract types, as in the regulations, tends to train contracts personnel to think in "tunnelvision" terms and has a stifling effect. The Government suffers the consequences of inability of its staff to negotiate the best contract agreement obtainable because the labels are sometimes viewed as inviolate. While standard contract types are appropriate for modest sized contracts, or repetitive buys, or quick reaction situations, they become a hinderance in very large long-term programs which need evolutionary systems.

#### Questionnaire Item 13 Comments

- o The defense industry is probably the most influential segment of the U.S. labor force. Above average compensation can and often is offered to employees because the cost will be passed to the Government on the cost type contracts, which most major defense contractors have. During the past recession, defense contractors were still giving above average wage increases to employees.
- o Federal employees get lousy COLA increases. The Government should similarly restrict the amount of labor dollars increase paid to contractors.

#### Questionnaire Item 14 Comments

- o Interest expense is not an allowable cost.
- o Oftentimes, we allow the contractor to owe the Government for years. During that time, the contractor is authorized to earn interest on the amount owed.

#### Questionnaire Item 15 Comments

- o CAS 414 motivates contractors to invest in capital assets, but not necessarily increase efficiency. CAS 414, in my opinion, did not implement the intent of "Profit '76". Too many elements of investment are allowed under CAS 414 which do not contribute to efficiency--"these items" merely deplete the DoD budget with no real return. A revision of allowable "investments" should be accomplished.
- o I would like to see the COM eliminated.
- o Depending on how you choose to look at COM, it is now profit as well as cost.
- o I think my idea would certainly speed up PCO/Buyer negotiation--and would certainly be more equitable. The annual or semi-annual forward priced profit negotiations could also place emphasis on past performance in order to encourage quality production and timely deliveries.
- o Cost of money treatment in cost type contracts is very confusing--the distinction between the fee before and after offset becomes blurred during negotiations with the resultant negotiated fee "raised" to a level of acceptability regardless of the cost of money allowed. On cost type contracts, no offset should be allowed (the net effect would be zero since fee is reduced by the exact amount). To leave the contractor whole, cost of money could be allowed on cost overruns, as is now the case.
- o Cost of money may have been designed to motivate contractors to invest in certain capital; however, in my 16 years of experience as chief of a pricing division and 6 years experience in a buying division, I believe we missed the boat on this one and no contractors are investing in capital because of this provision. There is no contractual clause or provision to require him to do so; therefore, he will not invest voluntarily.
- o COM is a rip-off. I continually ask the prime contractor for examples of facility investments and I continue to get "micky mouse" answers or their negotiator doesn't know. Hell, they aren't going to tell the Government they bought more efficient equipment because they know we would price accordingly. GE, Binghamton, NY installed numerous tape controlled equipment three years ago and I found out about it by accident through DCAS. You should hear the screams about going back and repricing the previous contracts!

#### Questionnaire Item 16 Comments

- o DoD usually has sufficient time, knowledge of the contractor's proposal, and experience on large, highly visible programs such as the B-1B bomber, M-1 tank, etc. On other programs, and in the central procurement activities, there frequently is not sufficient time, knowledge or the contractor's proposal is rudimentary and almost

entirely based on DCAA audit reports and ACO inputs; and the experience base of the buyer/PCO is rapidly declining because: (1) lack of manpower has forced shortcuts which preclude thorough evaluation of proposals, alternatives, and cost-cutting techniques; and (2) retirees are replaced by buyers and PCOs who have never had the luxury of time to really explore and apply the sophisticated techniques already available in the FAR and DoD FAR Supplement to evaluate programs, proposals, and ways to achieve real cost savings and/or more effective production. In the aggregate, these central contracts and contracts for less than major systems, account for many billions of dollars. Hence, my reply to the first three questions under #16. There is an important lesson here: No policy, e.g., profit, multi-year, financing, etc., can be effective without adequate resources to execute the policy. Sincere good wishes won't work.

- o The level of pricing expertise within the Air Force is very low compared to defense contractors and the academic community. This is compounded by a total lack of expertise available to support the PCO in the areas of industrial engineering and "should-cost" labor estimating. We are good at number-crunching and pricing mature weapon systems, but that is all.
- o We do not arbitrarily assume that the proposed price is inflated, but almost always during the course of the proposal evaluation it is found that the proposal is inflated and is caused to a great extent by the contractor's desire to increase his base in order to get more fee and/or profit. The contractor seldom, if ever, underruns a cost type contract because of wanting to keep the large labor base, even for incentive types.
- o The lack of adequate Government in-house technical support is costing the government (DoD) more than the industrial base that needs improvement.

Yet, DoD seems to over estimate the technical support provided to contracting. Just because the positions are filled (now with trainees), a capability is assumed.

- o The present entry requirements (3.5 GPA or Master's degree) to enter GS-1102 series at Grade 5 is not conducive to recruiting and retaining competent DoD Contract Specialists/Negotiators.

(1) Someone with a business background or an MBA will not come to the Government at GS-5 level. (2) DoD ends up with Spanish majors or social science majors that cannot get jobs elsewhere and have no background in business, accounting, etc., necessary for effective contract negotiations. (3) By the same token, most senior negotiators are GS-11/12 and are sitting across the table negotiating with a much higher paid contractor who has a background in business and accounting and is much better prepared to negotiate in his best interest than the Government negotiator. (4) To compound this problem, morale is low with Government contracting people because they continue to hear of planned downgrades for the 1102 series. The more competent Government contracting people are leaving to accept much higher paying jobs in the private sector and this trend will continue unless higher graded positions are available in the 1102 series.

- o Technical evaluators expertise is usually pretty good on the common production type contracts. However, sometimes their expertise is not adequate on the uncommon production of test stands, or software which is not frequently produced.
- o It appears that DoD never has sufficient time to properly negotiate a contract, particularly for major acquisitions. The Program Manager is usually late (not always his fault) in furnishing requirements to the PCO that pressures him/her to expedite the contracting function to make up for lost time.
- o We lack meaningful technical reviews (manufacturing, engineering, labor hours and material scrap rates).

### SECTION III (Continued)

#### Comments Related to Specific Questionnaire Sections or Items

##### Profit Policies and Practices (Questions 17-37)

###### General Comments

- o Weighted guidelines should restore contractor performance (past) criteria which used to be a "below the line" factor.

I do not agree with contractors' "double dipping" of FMS contracts by having overhead and G&A accounts that bear fee which already include domestic G&A and overhead.
- o I have questioned for some time the conception we have that profit rate and profit dollars on a contract for a major system represent the contractor's actual profit. For example, a contractor can make more money on an FPI contract by going to ceiling thereby completing the effort at target. If he has a significant commercial market he has the Government contract pick up the overhead costs and increases the profit on his commercial program. For those contractors who have a very small commercial market, they make more money at ceiling simply because of the cash flow generated by the additional income and the number of costs charged for work not performed--strong language I know, but I believe close scrutiny of contractor files would bear it out. Despite this, there is nothing wrong with the system--leave us with weighted guidelines, as bad as it is, any change is bound to be worse. Forget the idea that profit incentivizes increased industrial base--when we want to increase the base we will do as we have always done--pay direct.
- o Government Profit Policy encourages the offeror to be labor intensive, and to seek higher cost. The more cost in general and more labor in specific, he can justify, will raise his profit. Without the equipment in his plant, he can often justify high amount of labor to finish the job. To the investor, he must justify his return on investment, to the Government, he must justify his cost. A double standard. His main drive is to justify his return on investment as that determines whether he is employed by the investor. Justifying to the Government his cost is secondary. We should influence him in the same way he is influenced by his investors.
- o (1) Profit is still considered a dirty word, (2) Profit is the reason companies are in business, (3) I feel profit levels reflect directly on deliveries, quality and truthfulness of proposals, (4) We are neither flexible enough, nor willing to recognize better work deserves higher profits.

- o I don't believe profit and its function in a business is fully understood by DoD negotiators. Although it was found to be too confusing by most who used it, the prospective method of profit determination tested in "Profit '72" contain most of the elements of profit and return on investment and lead to a better understanding of profit. I would look into it again, at least as a possible training tool.
- o All the tools in the world will not correct input data that are faulty. We get a contractor's proposal and then proceed to determine the reasonableness of it. When will we gain the experience to determine what an effort will cost before we solicit proposals? Our method now is based on previous buys never market surveys or reversed engineering.

Questionnaire Item 17 Comments

- o Profit rates are generally too low on defense contracts. A policy leading to higher rates would attract increased competition and permit greater capital investment.
- o Other factors contribute as much or more to contractor capital investment. Some of those are: cost of capital, guarantee of adequate return on investment, and competing areas with greater return on investment.
- o MANTECH and TECHMOD programs give ample evidence to the opinion that DoD profit policy does not provide adequate incentive to modernize plant and equipment. If DoD profit policy was adequate, the need for these programs would be greatly mitigated.
- o The tools that we use can be effective if the data which we base our input on is realistic, rather than just contractor derived.

Limited industrial base is true. Our position even during peacetime is that time will not allow us to develop new sources. I do not mean alternate. I mean new.

- o (a) "Viability" is a very broad term which may lack uniform definition.
- o (d) "Lowest possible cost" in this and other questions is probably not the correct term; i.e., "lowest possible" may not be the objective, but rather what is fair and reasonable. Lowest possible has connotations of buy-ins, contracting to budget, etc., without regard to true effort involved, etc.

Questionnaire Item 18 Comments

- o Capital investment may result in very large labor savings but lower absolute profits. In return, we offer contractors a small share of their productivity improvement savings which probably pales in comparison to the return on investment they can realize in their commercial work.

#### Questionnaire Item 19 Comments

- o Profit policy should reflect performance more than it does today: contractor performance (inventiveness, investment, risk assumption) and product performance (reliability, maintenance requirements). We need to assure contractors that we will reward them handsomely for building quality, reliable, trouble-free items that work, and for producing them very efficiently. Perhaps we could add a bonus item, to be awarded upon completion of performance and solely at the discretion of the Government (like award fees), to reward outstanding performance. In any case we should have a system that would allow higher profits to the contractor that consistently produces better products at reasonable prices.
- o We should look at what motivates contractors. I believe it's ROI and semi-annual/annual reports that must be made to investors/stockholders that motivate contractors to seek X amount of cost and Y amount of profit; not just profit alone.
- o On unpriced orders and letter contracts there should be no reduced risk allowance for incurred costs. It is not right to ask the contractor to take one of these contracts to get faster delivery and then reduce his profit because he has already incurred cost by the time the price is definitized.

#### Questionnaire Item 23 Comments

- o Why should contractors reap "windfall" profits merely because economic inflators rise? The private sector has no such indexing!

#### Questionnaire Item 24 Comments

- o Should be neither simplified nor complicated, but reasonable, workable and trackable. Whatever is necessary to achieve these three should be objective. Objective to simplify is not objective, but rather could be an outcome from objective attainment.

#### Questionnaire Item 25 Comments

- o In my opinion, the cost-based method of determining profit yields an unrealistic high reward for contractor effort.
- o Basing profits on costs only encourages inefficient practices and motivates contractors negatively to increase their cost base.

#### Questionnaire Item 26 Comments

- o What about R&D contracts?

#### Questionnaire Item 27 Comments

- o I strongly feel that profit should be based on "Return on Investment" in lieu of a WGL technique.

Profit and overhead is based on direct dollars which encourages the contractor to submit an inflated proposal.

Questionnaire Item 28 Comments

- o Material costs may often be 50-60% of all costs. It can require tremendous management on part of prime to ensure timely deliveries from all vendors. Yet, the weight factor is nominal in comparison with other cost elements on WGL.
- o Weight Range in CITP: The WGM does not adequately consider co-production efforts. Possible solution which merits consideration would be: Exclude from subcontract base and conduct individual WGM for each of the co-producer costs.
- o The weight range in the CITP is not the problem. It's the 30% adjustment factor.
- o The WGL can be adjusted to accommodate whatever profit fee you wish to justify.

Questionnaire Item 30 Comments

- o Weighted Guidelines are most often used to justify the lowest profit/price position possible.
- o I have been a price analyst for over 22 years. From my experience, profit rates with WGL are about the same as they were before WGL, with a possible tendency towards higher rates. I must also address Cost of Money (COM). Both the WGL and COM take time highly disproportionate to results obtained. On one of my recent cases, it took almost a half day in COM computations alone, in order to maintain unit and line item price integrity, on a multi-line item contract. It took about the same amount of time in WGL computations to make the profit rate fit in with a range of generally accepted local profit rates. In summary, it took me almost a day in nothing more than computations and re-computations which, in terms of dollars, added nothing of major importance to the price. Before WGL I used to judgementally determine a profit rate in about a minute, without any time consuming computations, and the results were just as good. My time, as well as that of field auditors and field price analysts, is more profitable in analyzing direct costs (labor hours and materials), indirect costs and historical information for comparative purposes. This is easily seen in comparing to a determination as to whether a particular cost of money factor should be .004 or .0039 percent, for example.

If the WGL and COM are eliminated (and I hope they are) we do not, repeat, not need any replacement. Any replacement method would probably be only more time consuming and cumbersome than the one we now have. We need only two basic rules--common sense and good judgment.

If anyone doubts me, all that person would have to do is clock the time it takes to compute cost of money and profit by means of the weighted guidelines, and then measure the results in terms of the total contract price.

I have submitted suggestions before, but I cannot see that they have ever been favorably acted upon. For this one--I'm hoping.

- o I would urge more use of WGL rather than less. It at least forces a discipline on the price analyst or contracting officer that requires some thought and analysis. I think we get some consistency this way and are subject to direction if there is a profit policy change: I feel it really makes determining a fair profit easier to use WGL.

Re: Facilities Cost of Money--It is a strange concept. I feel it would be more realistic to put it into profit, and admit that it is such. If we don't want to reimburse the contractor for interest, then forget COM altogether.

- o I believe WGL could be discontinued and a profit range established for each type of contract and allow the price analysis to decide the appropriate rate based on the merits of the particular case. Then one short paragraph could be written explaining the position used in the range or why it was excluded or was below the range and eliminate all this documentation used now.
- o The present WGL is too cumbersome--don't know that we need three methods--R&D, Services, manufacturing. The DAR is not clear regarding the use of facilities on different types of contracts or the definition of "facilities". The way some contractors account for capital employed can distort the DAR intent regarding facilities in my opinion.

I think the present WGL could and should be simplified and improved.

- o WGL is a useful tool, but too much emphasis is put on its outcome. It is easily manipulated and judgement as well as mathematics should be a determinant of profit payable. Negative incentives as well as positive incentives within the contract will produce more quality products and could expand the industrial base if used wisely.
- o Contractors should be rewarded by higher profits for lowering manufacturing costs, thereby lowering the overall cost to the Government. Under current profit policies we penalize the contractor who reduces his operating costs by only allowing the "same old" profit rate regardless of his performance. Weighted Guidelines for profits do not allow the latitude necessary to reward a contractor for more efficient cost contracts.
- o The WGL is a joke!

Pricing, profit, etc., has no influence on quality. Quality is a matter of corporate reputation and commitment.

Flex progress payments have been very beneficial on large system contracts. It has greatly improved cash flow.

- o Contracting Officers should give briefings to contracting team members as to how the weights should be used in determining the profit for Service, manufacturing and research. If more than one contract

negotiator writes changes and negotiates on the same contract, each person should be familiar with the strategy and negotiating objectives of that particular contract.

- o The WGL method of determining profit and also defining what a reasonable profit is, is extremely inadequate.
- o While it is nice to have all the WGL weight ranges spelled out, the profit/fee rate developed by the Government seems to always be conservative and in case of R&D computations a negative fee has been known to have been developed. Seldom, if ever, is the WGL developed rate obtained in negotiation and quite often the negotiated rate is considerably higher than the WGL rate which is often unrealistically low. Contractors also use the WGL against the Government negotiators. They use higher weights and more factors to justify their position. It's my opinion that the WGL accomplishes nothing, but it does provide more work for Government employees. We might learn from our European counterparts who establish what the profit/fee rate will be and there is really no negotiation. If my memory serves me correctly, the fee/profit rates used before WGL were just as effective in negotiations as the rates developed using the WGL and were much less costly to develop than by the present method.
- o WGL is not difficult to apply for an experienced Contract Price Analyst--for Contract Specialists and Contract Officer's to use it-- well lets face it--it's an exercise. They do not have the training or the knowledge to know what to do with it and to simplify it so that they can understand it would compromise the validity and value of the policy.

#### Questionnaire Item 31 Comments

- o Response is directed to the enervative language contained in DoD FAR SUP 15.902 f., which fails to sufficiently provide the basis for a determination of "significant amount of facilities".

#### Questionnaire Item 33 Comments

- o Our command does not even use this factor.

#### Questionnaire Item 34 Comments

- o All too often, management intervenes and establishes the profit/fee objectives on both sides of the scale; i.e., too high or too low. Profit is just one (1) element of cost to the Government!

#### Questionnaire Item 36 Comments

- o Do not understand whether "profits actually realized by a contractor" relates to profit on that government contract, or on general business of firm.

Profit rates on previous contract were negotiated after WGL was prepared. If couldn't negotiate previously recommended rate probably cannot negotiate less on current contract. Many contractors insist on a certain profit rate for a Firm Fixed Price contract regardless of item procured.

### SECTION III (Continued)

#### Comments Related to Specific Questionnaire Sections or Items

##### Contract Financing Policies and Practices (Items 38-45)

###### General Comments

- o Do not work in area of Progress Payment Provision, work within cost type contracts only. However, all types of special provisions would affect profits objective.
- o DoD contract Financing Regulations should be reconsidered on the basis of commercial business procedures. Briefly, large contracts for commercial equipment and installation should be considered for advance payments in line with commercial practices.
- o The Contractor's return on investment may not look too bad, but the amount of investment for the amount of sales for a large manufacturer is low. By basing profit on investment instead of cost, he will invest heavily to obtain more profit if we allow for a good rate of return to the investors. People will be willing to invest with a good rate of return. However, do not expect contractors to catch on quickly. It took many contractors two or three years to catch on to CAS 414.

Due to instability of Government Programs, there is a need to improve coverage of facilities investment. It is easier to lay off workers to cut cost than to sell equipment to reduce debt. Contractors cannot switch their facilities to new product or programs without much cost. The Government needs to stabilize their procurements or improve the termination for convenience coverage on long-term facilities debt. Also, cut the coverage for labor lay-offs. Very few people outside the Procurement Directorate understand pricing, cost analysis, or profit analysis. They usually believe they know a lot about procurement. Their lack of knowledge impedes out analysis of contractor's proposal and establishment of a fair and reasonable price, including profit. Many have a predetermined profit for a procurement, regardless of the WGL or any other analysis. These misconceptions also hinder us during negotiations. And, in their hurry to settle, they pre-empt the contracting officer. The Project Manager and DARCOM HQ are known to do this frequently.

- o Many of the clauses designed for "social programs" that don't contribute to the end product increases the cost substantially.

In the commercial investment world, investments are made based on risk to investor and the assumed return for that investment. The Government should base profit on the amount for invested capital and the amount of risk the contractor assumes. The higher risk to him, the higher risk to the investor. The risk to Government Contractors are considered high. There needs to be a standard established to balance the analysis of profit between return on investment and risk. The relationship should be flexible. Also need to establish a continuously updated good rate of return to keep the profit analysis currently effective.

Questionnaire Item 38 Comments

- o The tools that we use can be effective if the data which we base our input on is realistic, rather just contractor derived.

Questionnaire Item 39 Comments

- o Pricing and profit we considered in the negotiation arena. Financing a contractor entails different considerations like responsibility/realism of projected cash flows, etc. (see DAR-E). This question is not germane to the topic of contractor financing.

Questionnaire Item 40 Comments

- o Experience here is limited to one large business contractor which is receiving 100% flexible progress payments as computed by Progress Payment Model and approved by Headquarters.
- o The present Flexible Progress Payments should be cancelled and an across-the-board provision for payments up to 100% be established thereby eliminating an ineffective administrative exercise.
- o Flexible progress payments should be discontinued and we should return to a flat rate of 95% for small business and for large contractors.

Questionnaire Item 41 Comments

- o Current profit rates should be standardized as to return on investment and incentivized to reduction of cost of contract performance.
- o We're too liberal with progress payments! Contractors should be required to provide a large share of their contract financing. Too many companies exist on defense business only simply because DoD provides the financing. A defaulted contract, or any failure of the company, causes substantial losses to the Government in unliquidated progress payments. It is recognized that this would increase prices.

### SECTION III (Continued)

#### Comments Related to Specific Questionnaire Sections or Items

##### Contractor Investment Incentive Policies and Practices (Questions 46-56)

###### General Comments

- o Investment Incentive--Cost of Money (COM) should be eliminated. It has not been demonstrated that it has had any affect in facilitating the contractors' plants and has only resulted in increased profits to contractors at additional cost to the Government. Its continued existence cannot be justified.
- o The single most critical issue to obtaining the lowest contract cost and quality products and to encouraging contractor investment in plant and equipment is program stability. The current boom or bust philosophy is very costly. When contractors can depend upon program and funding stability, they will invest. When such stability is lacking, facilities and investment will be put to other uses as has been done in the last 30 years. A five-year program of \$100 million per year is a far greater motivator for investment purposes than one of \$400-0-0-400-0 million.
- o On questions 46-56, about Investment Incentive, I do not have enough experience or knowledge to comment intelligently.
- o While contractors frequently complain about incentives to invest, etc., they almost always conveniently ignore the "cash flow" advantages of DoD contracts. While profit rates under the return on investment formula may be lower for DoD work; the "turnover" aspect of the equation is extremely lucrative for DoD work.

###### Questionnaire Item 46 Comments

- o Too early to tell, but IMIP may be a method of incentivizing industry to invest in new modern capital equipment thereby increasing productivity while optimizing profit.
- o FCOM is used as additional profit by many contractors. They use it to buy office buildings and facilities for which no immediate work is contemplated, thereby adding to DoD cost rather than lowering them. A good profit range and competition should be sufficient incentive for contractors to invest. However, program and budget stability would be a much better determinant. Once a program is approved by Congress, if they would leave it alone, except in exceptional cases, more contractors would be willing to do government business.
- o Stable requirements and additional profit (incentives) would lower cost and improve industrial base.

#### Questionnaire Item 47 Comments

- o Cost of money is an imputed cost but I consider it the same as profit or money available for contract financing.

#### Questionnaire Item 48 Comments

- o Must define cost reduction investment uses--nice to have facilities, etc.
- o The Questionnaire seems slanted in one direction. For example, Question 48 will receive diverse answers because of the word "would". My first reaction was to assign a "3". Then I changed the word "would" to "should" and entered a "4". In other words, present policy should result in cost reductions, but whether they really do is another matter.

#### Questionnaire Item 49 Comments

- o There is not a sufficiently large industrial base for steel castings and forgings, particularly for specialty steels for armor. The U.S. industrial base for steel is weak and declining. Otherwise, the base is considered sufficient.
- o The industrial base is independent of any labeling as prime or subcontractor. Any of these firms can be primes and subs at the same time.

#### Questionnaire Item 50 Comments

- o There is not a sufficiently large industrial base for steel castings and forgings, particularly for specialty steels for armor. The U.S. industrial base for steel is weak and declining. Otherwise, the base is considered sufficient.

#### Questionnaire Item 51 Comments

- o Size of contract value determines whether the 16-20% is too small.
- o No control on what types of investments. The range is not determining factor on production cost reductions.
- o COM and Facilities Capital Investment will never incentivise contractors to invest in facilities. If the Government is serious about increasing the industrial base then they will set up an annual funding program similar to IR&D and B&P.
- o This profit factor will always be too low unless it equals the amount of the cost reduction achieved by the capital investment. This is true because the contractor loses the cost reduction (additional profit) in the next production lot because of the Government's right to examine the books.

### Questionnaire Item 53 Comments

- o True long-term savings will result when the scope of fee determining officials views change to encompass long-term reliability and follow-on contracts. For example: a very costly satellite development project can result in highly reliable satellites which endure for extremely long periods. The same program could easily save money up front, but unwittingly cause increase in number of satellites produced at values which can reach \$1 billion each.
- o "Other methods"? Like what? No basis for comparison against capital investment. And? Grants? Diversifying?

### Questionnaire Item 55 Comments

- o If you want a contractor to invest capital, you must assure him of several years of sole source and forget about competition at the "earliest possible date."  
  
Why should we invest capital to reduce cost to the Government when the Government is going to give another company the "follow-on" buy before he has a chance to fully recover his investment of capital?
- o Instability of programs is the greatest single cost driver.
- o Question 55 doesn't make sense!
- o In this questionnaire--and perhaps in general acquisition practice even if not stated in formal policy--the ideas of contract pricing and contract financing (chiefly through progress payments) are compartmented from requirements planning, program stability and increased competition.

Contractors have little incentive to become more cost effective if they know they will receive the award (lack of competition); they also have a powerful negotiation advantage when they know the buying people have no choice but ultimately award to them.

To my knowledge, allowing cost of money and an extra amount in profit for capital investment has not motivated any contractor to make facilities improvements.

Contractors cannot afford substantial capital investment in a contracting atmosphere of feast or famine, which is usual.

There is presently no WGL consideration in relation to contract financing, other than the trifling facilities capital. Without something like progress payments, however, the Government might be forced to retreat from its long-held position of not allowing interest as a contract cost.

- o The effect on contractor facilities investment should be increased with increased profits, but I have entered a "D" since under the current WGM there is no way to measure or compare "profits" with "ROI", and ROI should be the prime motivator for investment in new equipment or more

equipment versus labor. Since the current WGM rewards labor intensive programs and does not consider ROI, "profit" as perceived by DoD appears to be counter-productive to DoD goals.

Consider two contractors with the same profit rates and projected costs under the WGM--but, with 90% Government investment for one and 10% for the other. A good example is General Dynamics versus Northrop. The ROI of Northrop is only a fraction of General Dynamics' and the Facilities Cost of capital considerations does not even begin to compensate for this since labor carries the higher credits. Given this, why should General Dynamics, even with higher profits, invest in capital equipment?

Questionnaire Item 56 Comments

- o Presently, I work in the closeout branch and only have primary buy responsibilities on an infrequent basis.

## SECTION IV

### Comments in Response to the Supplemental Survey Question

#### Responses Characterized as Positive

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**SUPPLEMENTAL SURVEY QUESTION:** At the 30 May 1984 Defense Financial and Investment Review Steering Committee meeting, many of the members expressed interest in understanding how you treat risk reduction provisions (such as economic price adjustments clauses, capital indemnification clauses and increased progress payment levels) when you establish your pre-negotiation profit objectives. Does the existence of these provisions influence you to offer lower profits than you would if they were not included? Do you believe they are helpful in achieving lower profits and/or prices for the government? If you have a firm opinion on this issue, please provide your comments in the space provided below.

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- o The increased progress payments provisions reduce cost to contractors and thereby reduces Government cost.  
EPA provisions reduce contractors risk, but should only be used on extended contracts (5 years). Two to three years of risk can be forecasted. Capital indemnification should only be used in large investment situations where the program is unstable with high risk of termination.
- o The existence of these provisions influences my WGL profit rate, but I have trouble with determining the impact for any one factor, such as EPA. There needs to be some uniform guidance. I cannot say if lower profit rates are realized in negotiations, but I feel it helps.  
Each contracting officer views this subject differently and gives it different consideration in negotiation.
- o Since these factors reduce risk, they should proportionately reduce that part of profit associated with risk. I believe they are helpful in achieving labor prices and at times, labor necessary to obtain performance because of otherwise unacceptable inflationary and programmatic risks. Good luck.
- o I think they do reduce profit rates.
- o Risk reduction provisions are instrumental in profit determination in that contractor's always use the risk factor as an important issue, the matter of program stability, inflation, reduction in quantities, are hotly debated during negotiations.

- o Yes, somewhat.
- o Any risk reduction measures, including the above, are considered in establishing the AF Objectives for profit. How helpful these provisions are is dependent upon the negotiator's ability to "see" his objective, the competence of his team and the contractor's management philosophies and competence in negotiations.
- o These types of provisions should reduce the profit objectives.
- o Any contract provisions which reduce cost risk are considered in the profit objective.
- o The answer to both questions is yes. Since profit objectives are tied closely to risk they do influence your objective and concomitantly what one is willing to settle for. Because it's there you react to it.
- o Anything that tends to reduce contractor risk should reduce contractor profit potential. This is not unlike high risk investments offering a potential of substantially greater gain than low risk investments.

EPA provisions should be routinely offered in exchange for lower profit potential. Likewise, Government financing should be offered in exchange for lower profit potential.

- o Less risk, less profit.
- o Yes. Yes.
- o (1) Yes. (2) Somewhat, but very marginally.
- o (1) Yes. (2) Yes.
- o I firmly agree that existence of EPA, increased progress payments and capital indemnification clauses do cause me to lower profit objectives.
- o Risk reduction provisions are influential in reducing the profit (fee) amount offered at this buying command during negotiations.
- o Theoretically, these risk reduction techniques should result in lower profits. In reality, they do produce lower profits sometimes, but not to the extent that I think they should.

I think these risk reduction techniques are very important on our very large system contracts.

- o An experienced negotiator will address above risk reduction provisions in establishing the weight for contractor's risk, especially on a large size contract. Thus, lower profits can be negotiated which ultimately affect the final negotiated price.

However, in my almost 29 years with the Government (19 years Army and 10 years Navy), I have encountered "negotiators" who will try to do their

best to match the contractor's proposed profit because they are too complacent to aggressively negotiate a profit/fee. This indifference hurts, but is a fact of life. I also met too aggressive negotiators who try to negotiate profit/fee down to the barest necessities--also unfair.

In my opinion, the most important basis for effective negotiations is a realistic and fair cost-line.

- o Risk factors are always considered in the profit objective. The clauses mentioned are helpful in achieving lower prices. EPA provisions are frequently used in production contracts with long delivery schedules.
- o All of the above mentioned risk reduction provisions are expected to, and I believe they do, contribute to negotiating a lower price when included in a contract. If one of the provisions will not contribute to a lower price, then it should not be included.
- o EPA - yes they do help and should be utilized to a greater degree. A more standardized model for "normal" use would be helpful.

Indemnification - Probably the best tool we have. Need to give it greater use--with simple implementation. If we wrap it in red tape as we are bound to do, might as well forget it.

Program Payments - no help here.

- o EPA provisions lower the overall contract cost as it helps to minimize the contractor's risk.
- o We do indeed offer lower risk consideration profit factors when EPA clauses are involved.
- o EPA provisions should only be permitted in contracts whose period of performance exceeds three years. Inclusion of EPA provisions has a direct relationship to contract risk evaluation. EPA provisions should not be utilized as a tool for "achieving lower profits".
- o Our organization has successfully used economic price adjustment clauses to offer and negotiate lower profits and lower total prices. This has been proven/demonstrated to my satisfaction with the higher profit and prices we had to pay and contractor screams we received on follow-on contracts from contractors where we refused to put EPA clauses in a second time.

Incidentally, the concept of EPA clauses is in general disfavor at HQUSAF RDC policy level at present. Although EPA clauses generally lower prices overall, it seems that budget people hate to have to hold contingency funds or dig up extra dollars when the clause does justify a price adjustment. People like EPA only when it works in our favor totally!

- o (1) Risk reduction provisions result in lower profit objectives.  
(2) Yes. (3) Yes.

Risk is a significant element in determining a profit objective and negotiating prices. Risk reduction provisions are extremely helpful in eliminating and/or reducing contingencies. It can make the difference in negotiating a fixed price type contract and a cost type.

- o If I reduce the risk, through risk reduction provisions, I would certainly not offer as much profit dollars to the contractor. Yes, these provisions are helpful in reducing overall cost to the Government.
- o The risk factor in WGL should be significantly reduced to the extent that the Government reduces the risk for the contractor by including EPA clauses. This is recognized by contractors and should be DoD policy.
- o (1) Yes. (2) Yes.
- o (1) Yes. (2) Yes.
- o The emphasis on risk reduction provisions should focus on which tool you use. To use an economic price adjustment clause would warrant a lower profit assessment. Use of a \_\_\_\_\_ indemnification clause should cause a lower price to be an objective, but not a lower profit objective. Increased progress payments should lead to a lower profit assessment since contractor costs should be lower.
- o Any risk reduction provisions carry with them a lower pre-negotiation profit objective. Lower profits are offered. I believe use of these type of clauses result in lower prices paid by Government. However, a vehicle for enforcing the provisions of the clauses at the cognizant administration activity should be implemented and adequate manpower provided for rigid enforcement of the provisions.
- o Risk reduction provisions are a definite factor in determining pre-negotiation profit objectives. They are somewhat effective in leading to a lower profit objective, but it varies on a case-by-case basis.
- o (1) Yes. (2) Yes.
- o Mostly we try deleting contractor requests for these clauses during negotiations. When unsuccessful, their use influences a slightly lower risk factor in the profit objective.

When used, they become a negotiation item by which the Government tries to reduce profit, however, contractors never admit to the effect.

Also, DCAA is usually so slow in approving/commenting on cash flow models for increased progress payments the negotiators have nothing tangible to consider during the pre-negotiation period.

- o (1) Yes. (2) Yes.
- o A contractor always requests flexible progress payments in order to minimize use of his own financial resources, which is fair. However, profit policy does permit us to take into consideration the unallowables,

such as the first two or three percentage points in the overall profit factor so the contractor in fact has no supportable complaint about his interest payment when the overall profit, billing and financing arrangements are taken into consideration.

- o In my opinion, more of these provisions should not only result in a lowering of profit, but should also result in a lower cost level being negotiated than otherwise would be (i.e., contract would increase cost bases for indemnification risks and abound escalation, etc.).
- o (1) Yes. Existence of EPA-type clauses reduces contractor cost risk.  
(2) Yes (see (1)).
- o The savings provisions referenced above should and do influence profit.

The WGL policies and factors used for capital employed are resulting in excessive profit objectives in many cases. If contractors continue to increase investments in this area WGL analyses will result in profits in excess of 20%. A change is required in the methodology of computing profit for capital employed.

- o Economic price adjustment clauses do not tend to encourage me to offer lower profits, but capital indemnification and increased progress payments do influence me in offering lower profits.

The level of progress payments generally paid to prime contractors on production contracts is considered to greatly reduce risk and should be considered in developing profits especially with the flexible progress payment provision.

- o Such provisions are closely considered when a pre-negotiation objective is developed. They are an effective means for reducing contractor risk and I see a direct relationship between such provisions and lower profits/prices to the Government. I consider the use of such provisions to be a trade-off for higher profits. I would like to see a greater use of such provisions which limit the risk to the contractor caused by conditions beyond his control.
- o (1) Yes. (2) Yes.
- o Yes. The erosion of profits due to inflation is a very real cost to the contractor and he can be counted on the pass the cost to the customer, us, instead of his stockholders. To the extent that the value of having an EPA can be quantified, it should be used to justify a lower profit rate (i.e., EPA protects ROI and ROI should determine profit rates).
- o (1) Yes, our basic position is not to use them if at all possible and consider only in the last resort.  
  
(2) Not so much on increased progress payments as I've found little or no impact on price. However, EPAs and particularly capital indemnification have a profound effect on contractor's risk assumption. Capital indemnification is probably the most critical, particularly in obtaining corporate funding.

(1) Make EPA a standard, rather than exception. (2) Tie progress payments to work performed rather than simply cost incurred. (3) Make capital indemnification, if directly related to the contract, standard.

We are too volatile in our programs to make a long-term capital expenditure worthwhile considering adverse Congressional action.

- o Increased progress payments are considered since would expect cost and therefore profit decrease.

Indemnification is rarely used since it is not Government's policy to indemnify.

Currently, IMIP program is attempting to fund realistic capital investment programs of contraction as long as Government is projected to share in efficiencies and swings. This planned approach may be more beneficial than merely revising/augmenting WGL, etc., since it involves detailed planning, program review, contractor capital investment projections, payback, etc.

- o Such actions do influence the PCO to lower profit since they are risk reducers to the contractor.
- o Yes. Yes.
- o (1) Inclusion of risk reduction provisions does influence me to offer lower profits.  
(2) Yes.
- o Yes. The more risk that is shared, the more willing a contractor is to take a lower profit.
- o Yes. Yes.
- o Since these provisions tend to reduce contractor risks, Government contracts personnel tend to negotiate lower profit rates.

I believe these provisions contribute to lower profits and/or resulting prices.

- o The prime contractors I have dealt with over the last few years have not asked for EPA clauses or indemnification. A request for increased progress payments was motivated by the new flexible progress payments model. Both requests were treated as a whole, and a fair profit was negotiated after considering all issues.
- o All of the above stated, in my opinion, reduce contractor risk and exposure. Therefore, I require my people to consider these when determining profit. I instruct them to use these as arguments for lower profits, then what the contractor's seeking.

I do believe they are helpful in achieving lower profits, especially when pricing out the out years.

- o (1) Yes. (2) Yes.
- o The type of contracts I handle do not contain such provisions, however, in the part I did have contact with, such provisions did result in lowering the profit level.
- o Detailed training to specialists required. Yes. Yes.
- o Inclusion of the above items virtually begs for a reduction, albeit minor, in price--based on the fact that to add these items to an existing contract, consideration (whatever it may be) must flow to the Government.

They are somewhat helpful in "forcing" a reduction in price.

As progress payments are generally applicable to FFP contracts, it is virtually impossible, at the bottom line, to separate profit and cost; although it is done arbitrarily at times, therefore, use of such clauses usually affects price alone, without differentiation.

- o If an EPA clause is to be incorporated into a FFP type of contract, I would offer the contractor lower profit dollars due to the reduced risk.

I believe lower overall prices are achieved when EPA clauses are incorporated into contracts.
- o I firmly believe that those financial stability techniques insure that contractors are willing to be more flexible at the negotiation table since they know that they will not be subject to fluctuations in the economy.
- o Yes. Yes. Risk reduction reduces contingencies in the price. The lower the risk, the lower the price.
- o All risk reduction efforts, such as described above, and others are considered and do reduce the Government objective for profit.
- o In using these provisions, I would probably lower profit somewhat based on the magnitude of the clause.

I believe these provisions help the Government lower prices.

- o Risk reduction provisions such as EPA, etc., are used in establishing a lower pre-negotiation profit objective than we would normally establish. They are helpful in achieving lower profits/prices and are used as trade-offs in negotiations.
- o Yes. However, profits are not too high if you consider interest rates and other investments a contractor can make, so the decrease in profit objectives is not substantial. Sometimes, they make prices lower, but they can make them higher. The indicies selected for an EPA clause, for example, may not reflect the contractor's actual costs. Overall, they probably result in lower price since many cost contingencies can be removed with their addition. My over-all concern is that you keep making

more rules and regulations making it constantly more difficult for contractors to deal with the Government. It also impacts the decreasing number of Government contracting personnel in getting their work done in a timely manner. There is less and less time to do a good job of pricing with the proliferation of new laws and regulations intended to increase competition, small business participation, warranties, data, social programs and management information system like AMIS. More emphasis should be placed on hiring, developing and retaining top notch people.

- o They do influence me to offer lower project objectives, however, the contractor objective and the Government objective is generally some distance apart because of their prospectives. Movement from the objective of both parties is necessary if any agreement is to be reached.
- o Absolutely! Flexible progress payments, milestone billings, advance payments, etc., can make very important contributions to contract price and performance. Contract financing should be offset by a reduction in contract price and frequently has resulted in reductions especially on large programs where adequate time and resources have been available to address this issue thoroughly. Milestone billings on one program (prior to flexible progress payments and when the usual progress payment rate was 80% for large business) saved over \$8 million. They also provided a strong schedule incentive in order for the contractor to improve his cash flow. Unfortunately, the guidance relating financing to price is not clear, and on many programs, the time is not available for much consideration of this issue anyway.
- o These are helpful and are often the only way a contractor will settle if such protection for him is there. It requires additional work, but less time is spent on wasted negotiations if both Government and contractor personnel are agreeable to such as the above. The program is not delayed and usually the Government ends up getting dollars refunded.
- o Lower profits/prices should be offered if risk reduction changes are used (and should be obtained).
- o The existence of risk reduction provisions definitely reduces my profit objective and the final profit negotiated. I am not convinced that this profit reduction is off-set by the increased liability to the Government resulting from the risk reduction provisions. I would prefer to allow a higher profit and eliminate these provisions. The absence of these provisions makes a contract more administratively manageable and leaves the contractor in no doubt that his is solely responsible for bringing in the product. My impression is that contractors find risk indemnification more attractive than the opportunity for increased profits.
- o In any situation where risk reduction (financial) is considered, it must have an influence on the profit objective and/or profit negotiated.
- o On the topic of EPA clauses, the answer is yes. The inclusion of EPA clause reduces risk. Profit should not be paid on EPA adjustments since the basic profit includes consideration for cost risk. To pay profit on the adjustment would be double counting.

- o Sometimes. Yes, to the limited extent permitted by regulatory requirements.
- o Generally, yes. Yes.
- o Yes, I firmly believe that such provisions influence lower target costs and profits. EPA provisions reduce the incentive for contractors to propose contingency prices for risks related to inflation. Since EPA reduces contingency pricing, it also reduces initial profits. Capital indemnification clauses tend to reduce program costs because they encourage contractors to invest in new, cost saving technology that contractors wouldn't otherwise invest in because of typical short-term profitability attitudes that are characteristic in contractor's capital investment phylosophies.
- o The benefits of the above items insure to the Government by allowing contractors/offerors to remove contingency elements from prices because the associated risks or cost drivers have been eliminated or reduced. There is no policy guidance that allows the PCO to deal with these items when establishing a profit objective, other than a "gut" reaction; therefore, they result in lower costs, hence lower prices.

In the case of a capital investment indemnification provision, its existence allows the contractor, especially in a competitive situation, to concentrate on reducing the price instead of avoiding risk exposure.

## SECTION IV (Continued)

### Comments in Response to the Supplemental Survey Question

#### Responses Characterized as Neutral

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**SUPPLEMENTAL SURVEY QUESTION:** At the 30 May 1984 Defense Financial and Investment Review Steering Committee meeting, many of the members expressed interest in understanding how you treat risk reduction provisions (such as economic price adjustments clauses, capital indemnification clauses and increased progress payment levels) when you establish your pre-negotiation profit objectives. Does the existence of these provisions influence you to offer lower profits than you would if they were not included? Do you believe they are helpful in achieving lower profits and/or prices for the government? If you have a firm opinion on this issue, please provide your comments in the space provided below.

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- o I currently work in a BOA area. Our delivery/orders are negotiated by an ACO.
- o Not sure if they help or hinder the overall picture of procurement-- Government or contractor!
- o (1) No. (2) Yes. (3) No firm opinion, but I think these provisions are a good idea. Their use should not have a great effect on profit objectives. They tend to preserve a reasonable level of risk.
- o No firm opinion, as my work is dominated by cost plus fixed fee or incentive fee contracting.
- o We consider risk reduction provisions in establishing profit objectives, but find extensive contractor objections.
- o No firm opinion!
- o No opinion.
- o Use of EPA clauses is held to an absolute minimum. The CO/PA should take inflation/escalation into consideration during the negotiations and use the tools provided to reach an FFP.
- o I avoid offering EPA and other risk-reduction provisions because of the administrative problems this creates. I offer progress payments whenever large sums are involved to reduce the contractors borrowing costs (interest). I prefer to advertise rather than negotiate to avoid discussions on profit. When negotiating profit, I usually exceed the WGL objectives.

- o EPA provisions influence my profit objective: The risk to the contractor is less. Capital indemnification clauses and increased progress payment levels do not.
- o EPA clauses are no longer authorized. Capital indemnification clauses never were allowed.
- o The provisions do not influence me to offer lower profits. Yes, progress payments do help to achieve lower profits and prices for the Government.
- o I believe contract provisions which reduce contractor risk and investment tend to reduce contract price (i.e., both cost and profit), from what would be negotiated otherwise. I use these provisions to counter the contractor's requests for profit beyond that indicated by weighted guidelines. I do not reduce the weighted guidelines profit objective because I do not believe the provisions are a bonus to the contractor. Typically, the provisions address aberrations which would put a contractor at an unintended disadvantage, if not countered. For example, a well structured EPA clause is as advantageous to the Government as to a contractor. It counters abnormal escalation beyond a contractor's control.
- o Have not had enough exposure to these provisions to comment.
- o Factors that reduce risk tend to lower the profit objective and "going in" position. However, negotiated profit on individual contracts tends to be more a function of what contractor expects as an average. Individual contracts do not differ greatly from this average.
- o (1) Yes. (2) Seldom.
- o I believe these policies need more education on the part of Government procurement personnel, more discussion with contractor personnel as to their effect and intended effect.
- o No. Yes.
- o Addition of provisions as noted, do impact profit objectives since the act to reduce contractor risk and since risk is a key element in the WGL method, reductions in profit are appropriate.

Contractors seem to ignor the fact that the Government offers such provisions and rarely recognizes their profit impact in initial offers. As a result, when final negotiations are concluded, we probably don't see appreciably lower profits.

- o I do not have enough exposure in this area to be able to offer any constructive opinions.
- o All policy and procedure is written for general procurement. Some employees will always misinterpret.. All financial aide must be considered--automatics lead to abuse. Improve knowledge in buyers is the only way to go.

Why has the Government enacted three million laws to inforce ten commandments?

Why write policy when no one suffers when they corrupt it?

Why lower the knowledge level of workers and write more policy?

Why establish proffesional standards and appoint unknowledgable leadership?

On and on.

- o It depends on the type of contract used. EPAs and indemnification are things beyond contractor control. If sufficiently risky, they should drive a cost type contract which in turn would potentially lower profit. However, under fixed price contracts they merely facilitate fixed price contracting and mitigate risk, not necessarily lower it. Use of any of these could lower prices/costs, thereby, as a result, i.e., percent profit on cost; lower profits. Contractors no longer have to increase costs to allow for every contingency; i.e., increases in insurance, increased financing, estimate of unknowns.
- o Yes. No. EPA clauses tend to disincentivize a contractor from controlling costs during contract performance. Therefore, they tend to offset any marginal reduction in profit that is achieved. In addition, these higher costs get compounded in subsequent buys. Allow higher profits and use the lower cost base for future subsequent buys.
- o Risk reduction clauses do have an impact on determination of profit objectives. I do not agree that they result in lower prices to the Government, since profit "saved" is more than offset by subsequent increased costs as a result of implementation of such clauses.
- o (1) No. (2) By reducing the cost to do business they would help in achieving lower prices for the Government, but they would have little impact on the contractor's year end profit rates.
- o (1) Yes, but that doesn't mean the contractor is willing to accept this premise. (2) Not always. (3) Pre-negotiation Profit Objective is just that: "Pre-negotiation". It may bear no relationship to final profit or price that is finally negotiated.
- o Yes, we try to negotiate lower profits for decreased risk, but it is not always possible. We are frequently pressured to expedite award in any way short of statutory violation. If a single source contractor hangs tough for a high profit, he only has to wait until the pressure builds.
- o Our personnel do consider the risk reduction provisions in establishing a profit objective. But, whether they actually negotiate a lower price because of these provisions is argumentative. Experience in competitive solicitations reveals that sometimes the low offeror has not requested Government financing assistance while his competitors have. In other instances, the low offeror has requested such assistance while his competitors haven't.

To really get a handle on the "cost" of using risk reductions provisions we need only to solicit with alternate proposals--bid "A" includes Government financing assistance, bid "B" does not. To properly evaluate bid "A", we would have to include the administrative costs, because they are real costs to the Government. Bid "A" may not be the overall lowest cost to the Government.

- o I have only dealt with one such situation. It involved foreign currency exchange rates. A window was negotiated that triggered the adjustment. A ceiling was also negotiated. Once the window was opened, the actuals were calculated and the negotiated burden rate applied without any profit. This lowered the risk to the contractor, the profit remained the same and the Government obtained a lower price.
- o 1. Award of progress payments, EPA, etc. should definitely be used as an evaluation factor in establishing profit objectives. Ceiling profit rates should be established for contracts having EPA, PPs, etc., as these substantially reduce contractor risk.  
2. Progress payments should be reserved for smaller contractors, not large prime contractors such as Bendix, Teledyne or General Dynamics.
- o Does the existence of these provisions influence you to offer lower profits. Yes.  
Do you believe they are helpful in achieving lower profits and/or prices for the Government. No.
- o Influence to offer lower profits - No. Helpful in achieving lower profits - No. Helpful in achieving lower prices - yes.

## SECTION IV (Continued)

### Comments in Response to the Supplemental Survey Question

#### Responses Characterized as Negative

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**SUPPLEMENTAL SURVEY QUESTION:** At the 30 May 1984 Defense Financial and Investment Review Steering Committee meeting, many of the members expressed interest in understanding how you treat risk reduction provisions (such as economic price adjustments clauses, capital indemnification clauses and increased progress payment levels) when you establish your pre-negotiation profit objectives. Does the existence of these provisions influence you to offer lower profits than you would if they were not included? Do you believe they are helpful in achieving lower profits and/or prices for the government? If you have a firm opinion on this issue, please provide your comments in the space provided below.

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- o EPA clauses do not necessarily influence profits. They are extremely difficult to project and are costly to the Government.  
We should simply not try to contract so far out into the future. No one can predict with any accuracy what will happen 3 to 5 years into the future.
- o The existence of the above provisions does not influence lower profits. Most contractors have a minimum profit that they will negotiate.
- o The issue of an EPA clause is included in the overall profit objective. I don't believe that an EPA clause does very much to reduce costs.
- o EPA has no effect on profit objectives although it does reduce risk. When involved with EPA, the contract is usually multi-year and sole source. After the initial contract is awarded, if changes or additional effort is desired of the contract by the Government, the Government is to a large extent, in a position to pay the profit the contract demands, EPA aside.

EPA is not helpful in achieving lower prices or profits for the Government and actually costs the Government by resulting in higher prices. EPA tied to an index measures the changes in the index, but it must be realized that contributions to the Bureau of Labor Statistics for use in developing quarterly indices, are totally voluntary and confidential. It benefits contractors to report higher costs than they actually have because all told, the indices will be higher and will result in contractors being paid more EPA than necessary. Further, EPA provisions are passed down to the subcontract level, however, only those

large subcontractors that control the market, actually get paid EPA according to the indices which the prime is paid. To the smaller subcontractors, which the prime controls, a much smaller EPA amount, or no EPA is paid. This results in the prime contractor's actual profit being greatly increased. Another method of computing EPA which may involve auditing of actual material and labor cost increases results in a spiral which begins with the contractor's knowledge that he will be paid for actual costs, therefore, what incentive does he have for controlling costs? Profit is almost entirely based on precedent. Pricing management continually strives to negotiate the lowest possible cost and profit, even if unreasonable to the contractor.

Why should we expect contractors to invest in capital and improvements when we are mostly requiring obsolete, not state-of-the-art or items made to a military TDP? Capital investment is beneficial to the contractor only when the Government is purchasing largely commercial items.

I'm not sure what is meant by capital indemnification.

Increased progress payment levels are sometimes taken into account when establishing profit levels. They do not achieve lower prices. Cost of money should be totally deleted from price when progress payments are allowed.

- o I believe that they result in reduced profit objectives; however, I don't believe that it results in lower negotiation results.
- o You are looking in the wrong place.
- o Avoid them at all costs. They are nothing more than a way to give away increased profit with no measurable benefit to the Government or the taxpayer.
- o These factors should reduce the risk, then the profit and the price. They are not helpful in reducing profits and prices in many cases.
- o Hardly considered at all. Weighted guidelines used to obtain initial figure. Then modified by judgment/management based on degree of costs already incurred, past history with company or product type, expectation of profit requirements to reach negotiated total price.
- o (1) Special provisions influence--none. (2) No. (3) Profits/fee should be based on return on investments, risk and performance. The special clauses are taken as given by the majority of contractors.
- o The existence of risk reduction provisions does influence me to offer to the contractor a lower profit, but my prenegotiation objective profit will not be lowered. In the absence of risk reduction provision (but assuming that a high risk situation exists) the prenegotiation objective profit will be increased.

Risk reduction provisions lower prices for the Government only because they set-aside the issue. The true cost to the Government is known only when the clause is exercised and then it could be an increase in cost (an example would be some of the EPA clauses).

- o Although the contract provisions should impact any WGL computations, too often Air Force management and DoD contractors are not willing to recognize these special provisions as having any impact on profit. This is true not only for those provisions defined above, but also for advanced payment provisions pre-contract cost allowance, and other financial aids.
- o They are not adequately considered in either the prenegotiation objective or the negotiated amount. Lower profits may be offered, but not accepted. Until contractors are required to determine profit on the same basis as we do, there will be problems.
- o Risk reduction provisions such as economic price adjustments and capital indemnification clauses are seldom used in NAVSEA contracts. The contractors usually do not request increased program payments until after the contracts are awarded so that the progress payments cannot be used as a negotiation tool.
- o To the best of my knowledge, no consideration is taken at this command for any risk reduction provision. I do not think they are helpful in achieving lower price/profits on Government contracts.
- o These definitely decrease contractor risk and should be reflected in WGL. To date, costs have increased due to EPA clauses. Initially, costs may be lower; ultimately, EPA clauses have increased costs with the problem of not having budgeted dollars available in the right year, etc. As inflation stabilizes, this problem won't exist--at the same time, EPA clauses won't be needed.

Capital indemnification approval process is too complex and lengthy to be useful or to impact costs.

- o (1) In general, I consider the risk reduction provisions not to be cost effective in handling Government funds. (2) EPA clauses, for example, do have a bearing on the profit rate to be achieved. (3) Here are my views on what should be done with risk reduction provisions.
  - a. I am not in favor of increasing progress payment levels, since current level should provide responsible contractors with a reasonable means of financing. After all, the Government probably won't realize any cost reductions if the levels are increased.
  - b. The EPA clauses should be eliminated in their place, the Government should recognize discrete risk areas on profit and contract types, within current guidelines. There should be more movement toward top-side ranges in lieu of falling back upon EPA clauses. The elimination of EPA clauses should cut administrative costs-on-balance, dropping EPA clauses should cut the overall need for Government funding for contracts as well as for administration.

- o I do not believe these have any affect on profit. A contractor anticipates a return for his efforts. The only advantage the weighted guidelines give us is a method of documenting how we arrived at a profit rate. As a general rule, the contractor has no such tool and is in a poor position to defend his profit request. It might be beneficial to require a contractor to support through weighted guidelines a profit proposal.
- o (1) Yes, these risk reducing provisions tend to influence me in writing the prenegotiation business clearance because risk is one of the elements of profit. However, I don't believe the Government derives any benefit in either lower profits and/or prices.
  - (2) These risk reduction provisions should be utilized at the discretion of the contracting officer for the following reasons: (a) Encourage contractor to effect timely completion of negotiations, (b) used as trade-off points, (c) negotiation leverage, (d) part of overall negotiation strategy! and (e) discourages contractor to seek identical negotiated profit/fee percentage points in previous contracts.
- o While the above mentioned factors obviously affect risk assumption, it is my experience that only minor adjustments in profits are realized. The real impact of not having such provisions in a contract is probably going to be reflected in costs elements because the contractor realizes that the Government negotiator is hard pressed to justify a high profit percentage. Therefore, costs are negotiated at an inflated level and a "reasonable" profit percentage is applied to these inflated costs which results in increased profit dollars.
- o Glad you asked! When inflation was rampant, a contractor would not sign a contract without an EPA clause. HQ policy guidance insisted that inclusion of such a clause must be accompanied by a profit reduction. We in the field could barely support the profit rate, using weighted guidelines, that we had to have to settle. Reduction of the rate was out of the question. Other risk reduction clauses, e.g., Burden Rate Adjustment and Flex Progress Payment, present the same dilemma. Profit rate cannot be reduced because of these clauses. Contractors feel they need those clauses to protect their profit objective.

This is one of the most glaring examples of HQ being out of touch with reality and thereby creating frustration at the working level. Come on down and show me how to negotiate a profit rate reduction clause. I would like to see your approach. By the way, you are two months behind the contract award schedule, so hurry up!

- o Does not influence offering lower profits, but are means to satisfy customer that equity has been received.
- o Sole source contractors force these on the Government, but the reduction in risk is rarely reflected in negotiated profit levels.

- o While EPA clauses have resulted in lower profit objectives, progress payment rates have never been used to influence either objective or negotiated profit rates. What is needed is a clear policy statement on the purpose for granting any form of Government financing. If the primary purpose of Government financing is to reduce negotiated profit rates, it needs to be stated clearly. To date, Government financing has not abated the historical trend of increasing profit rates. Taking away currently employed financing provisions would result in higher negotiated profit rates hereafter.
- o The Government does not receive adequate consideration from contractors, i.e., lower profits and/or prices, when risk reduction provisions are included.
- o Reducing the contractor risk in a sole source environment does not lower the contractor's profit expectations. It only allows him/her to make more money.
- o I believe that these risk reduction provisions should be avoided except when the risk being placed on a contractor is so great that it may affect the viability of the company to maintain operations.

When we, the Government, assume the additional risk by including these type provisions we do reduce profits by not comensurating with the risk we assume.

- o They do "not" help in achieving lower profits and/or prices for the Government. The contractors still want high profit/price "plus" EPA and increased progress payments.
- o What you guys fail to understand is that your policies may affect "objectives", but they don't affect results. A sole source contractor is going to get what he wants, period. All your policies and rules and calculations do is perhaps change the route they take to get it--but usually, they just tell you to take your WGL and shove it.
- o You can remove most or all risks and contractors will still want their same level of profit for which they will not invest the same into capital improvements (read: take the money and run).

Current DoD pricing, profit, financing and investment policies and practices provides a continuing basis for rewarding the same inefficient, slipshod, ineffective and unproven contractors that DoD has been doing business with the decades. Nothing will change until actual competitive contracting for both major systems and replenishment spares, forces those same contractors to significantly revise their "business-as-usual" approach when providing their tools and services. Without being subsidized by DoD, most of the DoD prime contractors would have been driven from the market place long ago.

- o The reduction provisions would tend to make you offer lower profit, however, I don't believe they are helpful in achieving lower profits for the Government. Most contractors don't feel these items should be matters of discussion during negotiations. And, they go after a certain profit level on every contract.

- o They influence me to lower my objective, but the results are still in the range of the historical rates for each particular prime.
- o The existence of these provisions are certainly taken into consideration in the Government's profit objective. However, the contractor is rarely interested in negotiating any reduction in his proposed profit as a result of including these items in the contract. It is becoming increasingly difficult to negotiate reasonable profit rates with sole source defense contractors. Competition would do more to get defense costs and profits in line than any type of financing or profit scheme.
- o I do not believe they are very helpful.
- o Economical adjustment clauses and progress payments should result in a lower profit than those contracts without these features; however, current policy dictates that profit should not be influenced by inclusion of these provisions.

In my judgment, we should, without a doubt, change our policy to reduce profit when we finance the contract. The contractor is using our money, and if he were borrowing, he surely would pay high interest.

- o With regards to profit the quintessential motive on the part of the contractor is to earn the maximum amount possible. Thus, since current acquisition regulations limit profit to 15%, many companies aim for this level. When being assessed by higher level corporate management, how well a contractor program manager/negotiator did with respect to the maximum level attainable is often one of the most closely observed and sensitive areas. Contractors look at costs as an area which their cost estimating departments can do a reasonably good job at projecting. Profit on the other hand is looked at separately, and very often (insofar as the contractor is concerned) limited to a very narrow range. For instance, some contractors will not take any work at all if the fee/profit level is below 8%. This is true irrespective of contract type also. Usually, no more than a handful of executive managers in a corporate division will conceive of the policy on profit to be followed by all the company's negotiators. Quite candidly, if the WGL was where the buck stopped, insofar as the Government's negotiating team was concerned, there would be far less contracts being negotiated. Financing provisions such as EPA clauses and flexible progress payments are viewed by contractors as tools which enable them to take on Government work in the first place. DoD contracts, it is often asserted, do not give the kind of returns that the commercial market place does. Why then, would a contractor take on a five-year, multi-year contract with all the attendant risks without the protection of EPA clauses? To the contractor, this is a pre-requisite to doing business, or rather to being able to do business with DoD irrespective of costs. Costs I believe are generally estimated using the same methods and processes whether the contract be cost type or fixed price type. The difference is that more margin (fat) is inserted into fixed price type contracts at the discretion of management.

Flexible progress payments are a concern not of the company's program management as much as the company's Financial Management. Reduction of interest on borrowed funds once again is looked at separately from the estimate of hardware costs themselves. When interest rates rise, the contractor knows that profits to be realized will be reduced. Therefore, he acts to reduce this impact. However, this is not such a pervasive factor that his decision to do business or not do business with the Government would be based. The bottom line here is that the contractor will take anything which acts to reduce profit. Profit is what corporations are made of. But, to think that they will rationally talk about profit, financing terms, incentive terms, etc., as one interactive package is perhaps a forelorn desire.

- o Every time you give industry a break based on their promises to invest in newer/better/more efficient capital equipment, they go out and buy another diversified business.
- o As a rule, risk reduction provisions are not taken into consideration when determining/negotiating profit and they should be. The more protection a contractor has with the various risk reduction provisions, the less his risk--thus, it has to be considered in establishing profit. Conversely, the opposite is true.
- o (1) No. (2) No.
- o Though in theory, these factors should affect profit objectives, I've seldom seen any real effect. Primary factors remain type of contract and price level of profit in preceding contracts.
- o Over the past ten years, or so, the DoD has been moving to give contractors more profit. With each step, there was a promise that it would bring more capital investment on the part of the contractor. I do not think we have seen more investment by the contractor. What we have seen is more financial assistance by the Government (e.g., flex progress payments, FCOM, special billing events, etc.).

It seems to be in the nature of things that the Government will continually take the risk of loss from the contractor. I think that it would be appropriate to keep profit low compared to that earned in the commercial world.

It appears that the incentives we offer seldom, if ever, affect the performance of the contractor. They are only important at the negotiating table--not during contract performance.

- o (1) Progress payments do not lower profit.
- o (2) If performance has started on a particular effort prior to definitization, I strongly use the extent of performance/actuals to lower profits.

- o These techniques are generally used as solutions to negotiation problems with major system contracts and are generally viewed as "add-ons". Rarely have I seen a pre-negotiation analysis that considered all these elements in an integrated package. Additional incentives are often viewed as "too hard to do" because of the unwieldy briefing/approval process.
- o (1) No. (2) No, however, you will not get the benefits of improved technology without a capital indemnification approach. The long run approach is that Government will pay less for an improved profit. For the instant contract, costs will be greater.

EPA clauses only cover risk of inflation--not the risk of performance which should be basis for renewal.

- o I have found in the very large dollar, very long duration programs a combination of:
  - a. Cost reimbursement contracts
  - b. Firm options, but with flexible option exercise dates
  - c. Firm option target values, but with possible reset of target cost (not fee) based upon date options are actually exercised
  - d. Carefully structured performance incentives including quality, field (orbital) performance, schedule (based on cash flow rate) and cost,

to be most suitable. The problem is to resist in contractor motivation when effects of inflation render very difficult a realistic balancing of separate incentive pools. The answer is to link them through a common "nexus" such as target fees. The limits of 15% (R&D), 10% (product) especially hinder such motivation.

The Government's motivation should not be to lower profits, but should be to achieve the best performance possible for each dollar spent. Most plans to "reduce profit", or "contract costs" are short-sighted and in the end, cost the Government much more to recover from. Excluded, of course, are programs to control abuse, or fraud, or poor business practices.

- o Staff turnover is such, as a result of current Office of Personnel Management (OPM) policies, that we have neither the trained people or time to refine each procurement in the areas addressed above.
- o I don't believe these special clauses help in reducing the level of profit. I believe many contracting officers rely on previous profit rates for each individual contractor that have been established by previous negotiations.
- o The question misses the boat. We are really talking about reducing cost risk. Can't make up that difference with profit, not with the political and other rules "to hold down profit".

- o 1. Inclusion of economic price adjustment clauses (which are, in fact, relatively rare) is regarded as reducing the contractor's risk. In some cases, these clauses are used in competitive solicitations requiring performance over a period of years in order to attract more bidders than otherwise might want to risk possible future inflation. In other cases, they are virtually demanded by the select-source contractor, whose negotiation leverage may also mitigate any risk penalty in profit.
- 2. I have had no experience with "capital indemnification clauses".
- 3. Progress payments, at any level, have no effect on profit under present WGL. I doubt if they should have, considering that the Government does not accept interest as an item of contract cost.

As a practical matter, contractors pay little or no attention to the WGL. There are exceptions, of course--but contractors who use them usually do so to demonstrate how some enormous profit can be shown to be "reasonable".

- o The clauses have no effect in achieving lower price or profits.
- o AFSC policy currently dictates that there will be no EPA provision included in any RFP. EPAs are not given any serious consideration for programs less than 3-4 years. EPAs are not to be used to game the system, but to forecast reasonable escalation (?) and to protect for abnormal escalation. The Reagan Administration has slowed the rate of escalation, however, no one is smart enough to know two years hence, what the rate of escalation will be, therefore, trend analysis is uncertain and vague in 5 years forecasting. Capital indemnification is given serious consideration for long-term program capital investments on our ASD programs. We do cash flow analysis to determine the need for flexible progress payments and, in most cases, they are approved. Our assessment of cost risk usually is determined by specification and configuration controls rather than return on investment or escalation rates that are not that significant. Why should we be motivated to lower DoD contractor profits if quality and cost are shown to be summarily increased and decreased, respectively? We should encourage greater profits for lower costs and better quality.
- o The risk reduction provisions cited above do not result in profit rates lower than would otherwise have been negotiated. Rather, these provisions in contracts generally imply the risk factor allowed in the WGL is not sufficient to cover the instant acquisition.
- o Pre-negotiation profit/fee objectives have not consciously been impacted by risk reduction features. To reduce objectives for such would generally be meaningless since the objective is normally conservative and not specifically attained during negotiations. It is my opinion that profits presently being negotiated are higher than they were during times with lesser risk reduction measures. Prices may be more realistic by elimination of some contingencies by appropriate use of escalation clauses; however, such clauses can also be abused.

- o They lower profits up front, but do little to lower overall prices. EPAs, indemnification, etc., remove all pressure from the contractor to control his costs or become more official. They in essence, make our contracts cost plus.
- o The provisions do result in a lower profit being offered, but, I don't believe they are helpful in achieving a lower profit because in the real world, the contractor is looking for a specific percentage of the estimated cost and is not usually related to the WGL or return on investment, but is the return they feel they deserve.
- o The existence of these provisions lowers my idea of what profit should be as I tend to put a great deal of emphasis on risk and private initiative. I doubt that they have much effort on ultimate price as factors included in price (over the long-term) have a way of balancing out.
- o Yes, we use these techniques, but the deck is always stacked in favor of the contractor. Lower profit rates are not achieved based on your paragraph above.

In the real world of contract negotiations with big primes, the key Air Force managers are pussy cats and larger profits are negotiated in the interest of getting a settlement.

If the PCOs had the authority to negotiate fair profits, this area would need no further study. The PCO is such a small part of the picture/process today, most company management personnel almost ignore them.

We do not need more high level guidance and studies. Let's have the PCOs do their jobs. Let's give them the authority.

- o I have occasionally been requested to utilize a lower profit objective in pre-negotiation clearances where escalation and financing issues appeared to lower the contractor's risk, especially when prior buys of the same items did not include such provisions. However, in my experience at the negotiations, contractors counter argue that other risks (direct labor and materials usually) are more risky than in previous years and refuse to make any meaningful concessions. On one such deal, we eventually settled with a profit rate about 0.1% lower than previous buys; dollar savings were less than \$100,000.00. I find in most cases that historical profit rates are the dominant influence in the negotiations.
- o Price adjustment clauses are so complicated to administration that most people don't want them in their contracts.

To include capital indemnification clauses takes too many levels of approval to secure authority to include them and so are not utilized as effectively as could be. Push authority to include down to "troops". The prices of contractors where these two provisions have been included were not lowered to any significant amount due to the inclusion of these clauses.

- o No. Contractor believes if he may use a clause, we, the Government should and he is therefore entitled to this assistance. Therefore, attempting to negotiate low profit or fee becomes a stand-off.
- o These have very little, or no impact on the pre-negotiation profit objective, however, we may use them during negotiations to argue for a lower profit or price. I don't believe they would result in lower profits or prices except during times of excessive inflation and interest rates.
- o In the main, we are not sensitive or educated in the risk associated with our programs from the private sector prospective. Negotiated prices are arrived at using cost build-up based on past performance of like or similar programs. Risk reduction provisions are like many of our terms and conditions that cannot be quantified as to their value to the Government, whereas the private sector is able to quantify its value to them.

(1) Their inclusion makes little difference on profit, (2) They may promote lower prices if they are handled by the DoD as items of value.

- o I usually consider the above risk reduction provisions in my objective when negotiating profits on other than smaller procurements. However, I know of no accurate method of estimating how much profit should be lowered. WGL is no help. The amount of risk reduction and the affect on profit can't be accurately measured under present procedures.
- o I believe the use of these provisions "boxes" us in on how willing we are to pay.

Lower prices should be what we are after, not necessarily lower profits! These should be, and are, ways of incentivizing contractors to invest their money, save operating costs, earn more profit by doing so if it lowers the price.

The worst above all practice we have that negatively affects prices, costs and profits is PROGRAM instability! Thousands if not millions of dollars are spent on useless proposals that just have to be thrown away to do a new one. Contractors and the Government suffers in dollars, frustration, reputation and price of the products we have to pay. Instability automatically forces firms to build in some amount of management reserve, spend unwisely and be ultra conservative in management. We pay the price!

- o These risk reduction provisions do have a slight influence on the objective profit; however, the reduced rate is rarely seen in the final negotiated profit. The only way to lower the negotiated profit is to develop an alternative to profit other than "cost based".

The DoD should concentrate on negotiating and controlling cost. This survey is very nearly the same policy expressed by all pricing policies-total emphasis on less than 20% of the price. Regardless of the negotiated rate of profit, 1 to 2% points in material and labor escalation can

significantly raise the contractor's actual rate of profit. In lieu of controlling indirect cost and streamlining administrative functions, we see such functions as purchasing, program management, engineering, quality control charged as direct costs--all covered by "approved disclosure statement" under current CAS. The increasing complexity of data and proposals--as well as the volume--makes it almost impossible to adequately evaluate them within reasonable time periods.

- o As I understand DoD policy, I can't penalize a contractor for EPA--progress payments, etc.

If I could offset profit progress payments would be the first priority. EPA is reasonable on cost, but it is not appropriate on profit. Profit on multi-million dollar defense contracts should consider fixed fee concepts rather than firm fixed price except on competitive procurements. That's "old fashioned" and "archaic", but then so am I. All these "new" concepts were tried forty years ago--they're just renamed.

- o (1) No consideration given at pre-negotiation. Management probably wouldn't receive any deviation from the WGL too kindly. (2) No offer of lower profit since the contractor has a strong argument in being hurt in no profit being allowed for "abnormal" escalation. (3) Profits and prices are probably about the same as they would have been without the provisions.
- o Under the current posture, EPAs are not being utilized as much as in the past few years since inflation has slowed significantly.

Progress payments have become such a way of life, they really have no bearing on profit objectives. The fact that the Government bends to the maximum to support small business makes progress payments a routine matter. A complete "relearning" would be required of industry to accept any different concept.

- o When the subject risk reduction provisions have been used in past contracts, the contractor tends to maximize costs and performs poorly.

The only way the contractor will try to control costs is when his profit is at risk. Therefore, the use of FPI or FFP type contracts is a method of achieving an overall lower price for the Government. Under cost type contracts, the contractor "buy-in" and then continues to drain the Government of funds. Experience with current contractors indicates overruns of 50-100% are not uncommon even on large contracts (i.e., over \$100 million).

- o I believe the risk reduction provisions listed could be extremely important in achieving lower profits and costs if they were more easily obtainable. By that, I mean, that the bureaucratic controls over and restrictions on using them are so tight that we almost never consider them in the interest of getting our contracts out on time. There is no reason the use of such provisions should not be authorized at the local level.

- o (1) Economic Price Adjustment--Yes, if I must assume the risk of an unstable economy, I offer a lower profit.
- o (2) Capital Indemnification--No. These clauses are in theory for the overall benefit of a specific program. The fact that I have entered into a long-term agreement with specific liabilities established would not motivate me to lower profit. The stability of the program is the risk driver and is not under the contractor's control.
- o (3) Increased Progress Payment Levels--No. While it may be a bona-fide item to be considered, it never is. Progress payments have been around so long the rate of payment and its influence on cash flow is not considered in establishing profit.
- o (4) Yes, for economic price adjustments and increased progress payments. No, for capital indemnification clauses. The process of obtaining approval for these changes is so time consuming and constrained by bureaucratic controls that they are almost never used. It's one of these that looks good on paper, but produces very little results because of constraints.
- o In most cases, the profits offered and negotiated are based on past experience with the particular contractor and risk of instant program, not other factors identified. I see virtually no impact on negotiated profit rates.
- o 1. Not really--they are used to preclude payment of higher profits. Usually, the company wants EPA clauses as a more political substitute for the percentage of profit they'd seek for the risk involved.
- o 2. Only in the sense I've described above. Contractors need a certain profit percentage the existence of the above features won't lower that percentage; they may keep the percentage from going significantly higher.
- o I do not offer lower profits because of them. In competition, a contractor will definitely propose a lower overall price because of them because they represent a very real savings to him. In a sole source negotiation, a contractor would probably not offer any price conversions because of these provisions. He may, however, offer certain tradeoffs to obtain these provisions in the contract.
- o No. Not really.
- o Risk considerations are usually used to bring into line the "Bottom-line" profit to accomodate local management profit policies. Most of the rest of the WGL is simply mechanical. Thus, the WGL becomes much more of a justification than a guide. The other items mentioned above are really only addressed on contracts over \$25MM, as this is a major administrative plateau.

**APPENDIX A**  
**SURVEY QUESTIONNAIRE**

## 1984 Defense Financial and Investment Review Survey

This survey is sponsored by the Defense Financial and Investment Review (DFAIR) group under the auspices of the Under Secretary of Defense (Acquisition Management), and is being conducted by the Defense Manpower Data Center (DMDC). Its purpose is to support a study mandated by the Deputy Secretary of Defense to identify possible revisions and improvements of defense pricing, financing, and profit policies towards meeting the objectives of Executive Order 12352, "Federal Procurement Reforms".

The number which appears at the top of the first page of the questionnaire is a sequence number and will be used for record management purposes only. Your anonymity is assured. DMDC will not release any individual data; only group statistics will be reported. Your participation in this survey is voluntary, but is encouraged so that the data will be complete and representative.

### INSTRUCTIONS FOR COMPLETING THIS SURVEY

1. READ EACH QUESTION CAREFULLY.
2. Some questions ask you to circle a number next to your answer.

**EXAMPLE:** Where do you live?

#### CIRCLE ONE

District of Columbia . . . . . 1

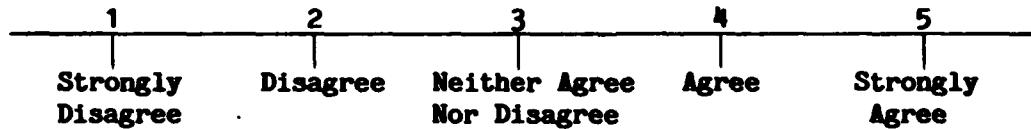
Maryland . . . . . 2

Virginia . . . . . 3

3. Some questions ask you to provide your opinion: (a) Refer to the scale that precedes the question, and then (b) write the number that describes your response in the space provided for each item.

**EXAMPLE:**

For each of the following statements, indicate the extent of your agreement or disagreement. Use the scale below and write your response number in the blank space provided next to each item.



A survey of the opinions of DoD procurement personnel:

5 Is a useful way to evaluate policy.

3 Should be conducted annually.

4. If you are unfamiliar with the content area covered in a question, leave the response space blank and go on to the next item.
5. If you have any questions about these instructions, please call the Survey Data Collection Desk at DMDC: AVN226-5850, or Commercial (202) 696-5850.

SECTION I. BACKGROUND

1. For which Service or other Defense activity do you work?

CIRCLE ONE

Army . . . . .	1
Navy . . . . .	2
Marine Corps . . . . .	3
Air Force . . . . .	4
Defense Logistics Agency . . . . .	5
Other Defense activity (Specify in the box below). .	6

2. What is the level of your current position?

CIRCLE ONE

Major headquarters position . . . . .	1
Director or deputy head of unit or activity . . . .	2
Supervisor or branch head of unit or activity . . .	3
Journeyman level . . . . .	4
Working level staff . . . . .	5
Other (Specify in the box below) . . . . .	6

3. Which of the following job titles **best** describes your current duties?

CIRCLE ONE

Price analyst. . . . .	1
Contract specialist . . . . .	2
Principle ACO. . . . .	3
Contract negotiator. . . . .	4
Procurement analyst. . . . .	5
Other (Specify in the box below) . . . . .	6

Questions 4 and 5 require you to enter a number. You should do two things:

- o Write the number in the boxes provided, making sure that the last digit is always in the right-hand box.
- o Fill in any unused boxes with zeros.

**EXAMPLE:**

In what month were you born?

You would record July as . . . . .

**0 7**

4. What is your current grade?

GS or GM: 

--	--

(If Military)

O: 

0	
---	--

5. How long (total service) have you been working in any defense contracting capacity?

Years: 

--	--

Months: 

--	--

6. What is the main type of materials or commodities procurement with which you deal?  
(Select only one.)

**CIRCLE ONE**

Ships. . . . .	1
Aircraft . . . . .	2
Missiles . . . . .	3
Combat Vehicles. . . . .	4
Communications & Control . . . . .	5
Overhaul and Repair. . . . .	6
Research and Development . . . . .	7
Electronics. . . . .	8
Other (Specify in the box below) . . . . .	9

--

7. With what value contracts do you principally deal?

**CIRCLE ONE**

Less than \$1 million . . . . .	1
Between \$1 million and \$100 million. . . . .	2
Over \$100 million. . . . .	3

## SECTION II. PRICING

For each of the following statements, indicate the extent of your agreement or disagreement. Use the scale below and write your response number in the blank space provided next to each item.

1	2	3	4	5
Strongly Disagree	Disagree	Neither Agree Nor Disagree	Agree	Strongly Agree

8. Current DoD PRICING policies and practices contribute to:

- a) \_\_\_\_\_ Maintaining the viability of the industrial base.
- b) \_\_\_\_\_ Efficient contractor performance.
- c) \_\_\_\_\_ Quality products.
- d) \_\_\_\_\_ The lowest possible cost to the Government.
- e) \_\_\_\_\_ Encouraging capital investment.

9. DoD PRICING policies and practices sufficiently take into consideration issues of:

- a) \_\_\_\_\_ Profit.
- b) \_\_\_\_\_ Contract financing.
- c) \_\_\_\_\_ Capital investment.

10. The DoD approach to pricing should consider the:

- a) \_\_\_\_\_ Type of contract.
- b) \_\_\_\_\_ Size of the contract.
- c) \_\_\_\_\_ Type of materials, commodity, or service.

11. \_\_\_\_\_ The type of contract used in weapons acquisition is frequently not the most appropriate one for the particular type of procurement.

12. \_\_\_\_\_ When negotiating firm fixed-price contracts, agreement is usually separately reached on the cost and profit portions of the contract price.

13. \_\_\_\_\_ DoD should establish a more explicit policy for determining the reasonableness of the contractor's employee compensation costs charged to defense contracts.

14. \_\_\_\_\_ Defense contractors are adequately compensated for interest expenses.

1	2	3	4	5
Strongly Disagree	Disagree	Neither Agree Nor Disagree	Agree	Strongly Agree

15. Cost Accounting Standard 414, "Facilities Capital Cost of Money":

- a) \_\_\_\_\_ Is very confusing.
- b) \_\_\_\_\_ Has motivated contractors to invest in capital assets.
- c) \_\_\_\_\_ Should be included in the cost base for determining profit.
- d) \_\_\_\_\_ Should be considered as part of profit rather than as a cost.

16. When DoD negotiates price with a contractor, it usually:

- a) \_\_\_\_\_ Has sufficient knowledge of the contractor's cost proposal.
- b) \_\_\_\_\_ Has time to negotiate an equitable price.
- c) \_\_\_\_\_ Has adequate in-house expertise.
- d) \_\_\_\_\_ Assumes that the proposed price is inflated.

### SECTION III. PROFIT

17. Current DoD PROFIT policies and practices contribute to:

- a) \_\_\_\_\_ Maintaining the viability of the industrial base.
- b) \_\_\_\_\_ Efficient contractor performance.
- c) \_\_\_\_\_ Quality products.
- d) \_\_\_\_\_ The lowest possible cost to the Government.
- e) \_\_\_\_\_ Encouraging capital investment.

18. DoD PROFIT policies and practices sufficiently take into consideration issues of:

- a) \_\_\_\_\_ Pricing.
- b) \_\_\_\_\_ Contract financing.
- c) \_\_\_\_\_ Capital investment.

19. \_\_\_\_\_ DoD should substantially revise its profit policies.

1	2	3	4	5
Strongly Disagree	Disagree	Neither Agree Nor Disagree	Agree	Strongly Agree

20. Profits realized by defense contractors are too low:

- As measured as a percentage of the selling price.
- As measured by return-on-investment.

21. There is little direct relationship between quality or performance of product and levels of profit.

22. The system puts a lot of pressure on contracting officers to keep profits down.

23. Profit should be allowed on escalation under economic price adjustment clauses.

24. The method for offsetting facilities capital cost of money should be simplified.

25. The cost-based method of determining profit:

- Yields a realistic reward for contractor effort.
- Discourages the development of new efficiencies.
- Tends to increase defense contract costs.

26. For manufacturing contracts, profit objectives should be based entirely on capital investment and risk.

27. Profit should be based primarily on the return-on-investment concept.

28. The weight ranges in the contractor-input-to-performance (CITP) section of the WGL do not properly reflect the contribution of the various cost elements to contract performance.

1	2	3	4	5
Strongly Disagree	Disagree	Neither Agree Nor Disagree	Agree	Strongly Agree

29. DoD could develop a two-tiered profit methodology to explicitly recognize the time-phased contractor investment in a contract (i.e., costs less government provided financing) on very large contracts, and a much more simplified approach for all other contracts.

a) \_\_\_\_\_ This would be an effective approach.  
 b) \_\_\_\_\_ This approach would be administratively practical.

30. The weighted guidelines (WGL):

a) \_\_\_\_\_ Are used more as a crutch to justify the final negotiated price than as a tool to develop an appropriate profit objective.  
 b) \_\_\_\_\_ Tend to depress negotiated contractor profits.  
 c) \_\_\_\_\_ Approach is sufficiently flexible to provide adequate profits to the majority of contractors.  
 d) \_\_\_\_\_ Format should be simplified.  
 e) \_\_\_\_\_ Should be eliminated.  
 f) \_\_\_\_\_ Should be used at the discretion of the contracting officer.

31. \_\_\_\_\_ Proper use of the manufacturing, R&D, and services columns in WGL is confusing.

32. \_\_\_\_\_ Regardless of WGL, contractors are out for a specific profit return on each contract.

33. The special productivity factor (line 19 in WGL) is:

a) \_\_\_\_\_ A viable tool for encouraging and rewarding improvements in productivity.  
 b) \_\_\_\_\_ Administratively too difficult to apply.

34. \_\_\_\_\_ The Government profit/fee objective is often dictated by management, regardless of the WGL computation.

35. \_\_\_\_\_ The weight ranges currently allowed in the WGL for contractor risk are too high.

1	2	3	4	5
Strongly Disagree	Disagree	Neither Agree Nor Disagree	Agree	Strongly Agree

36. Negotiated profit rates are:

- a) \_\_\_\_\_ Usually lower than those actually realized by contractors.
- b) \_\_\_\_\_ More closely related to profit rates negotiated with a particular contractor on previous contracts than they are to the WGL objectives.

37. \_\_\_\_\_ Foreign Military Sales (FMS) contracts should include higher profit rates to reimburse a contractor for increased risks.

#### SECTION IV. CONTRACT FINANCING

38. Current DoD CONTRACT FINANCING policies and practices contribute to:

- a) \_\_\_\_\_ Maintaining the viability of the industrial base.
- b) \_\_\_\_\_ Efficient contractor performance.
- c) \_\_\_\_\_ Quality products.
- d) \_\_\_\_\_ The lowest possible cost to the Government.
- e) \_\_\_\_\_ Encouraging capital investment.

39. DoD CONTRACT FINANCING policies and practices sufficiently take into consideration issues of:

- a) \_\_\_\_\_ Pricing.
- b) \_\_\_\_\_ Profit.
- c) \_\_\_\_\_ Capital investment.

40. The flexible progress payment model is:

- a) \_\_\_\_\_ Too complex to administer.
- b) \_\_\_\_\_ Too beneficial to the contractor.
- c) \_\_\_\_\_ More advantageous to the large contractor than the small contractor.
- d) \_\_\_\_\_ An effective method of insuring that an appropriate progress payment rate is established on a particular contract.

1	2	3	4	5
Strongly Disagree	Disagree	Neither Agree Nor Disagree	Agree	Strongly Agree

41. The standard progress payment rate:

- a) \_\_\_\_\_ Is too high.
- b) \_\_\_\_\_ Is too low.
- c) \_\_\_\_\_ Should be tied to current interest rates.
- d) \_\_\_\_\_ Should be 100% of costs incurred under fixed-price FMS contracts.
- e) \_\_\_\_\_ Should be tied to the contractor's borrowing rate.
- f) \_\_\_\_\_ Should be considered in establishing a profit objective.
- g) \_\_\_\_\_ Should be 100% for all contracts.

42. \_\_\_\_\_ If DoD lowers the standard progress payment rate, contract prices paid by DoD would increase proportionally.

43. Advance payments:

- a) \_\_\_\_\_ Should be used more often.
- b) \_\_\_\_\_ Should be used at the discretion of the contracting officer.
- c) \_\_\_\_\_ Would encourage more competition for defense contracts.

44. \_\_\_\_\_ When prime contractors flow down Government authorized financing provisions to subcontractors, lower prices to the Government result.

45. \_\_\_\_\_ Prime contractors flow down Government authorized financing provisions to subcontractors to the maximum extent possible.

#### SECTION V. INVESTMENT INCENTIVE

46. Current DoD CONTRACTOR INVESTMENT INCENTIVE policies and practices contribute to:

- a) \_\_\_\_\_ Maintaining the viability of the industrial base.
- b) \_\_\_\_\_ Efficient contractor performance.
- c) \_\_\_\_\_ Quality products.
- d) \_\_\_\_\_ The lowest possible cost to the Government.
- e) \_\_\_\_\_ Encouraging capital investment.

1	2	3	4	5
Strongly Disagree	Disagree	Neither Agree Nor Disagree	Agree	Strongly Agree

47. DoD CONTRACTOR INVESTMENT INCENTIVE policies and practices sufficiently take into consideration issues of:

- Profit.
- Contract financing.
- Pricing.

48. Increased capital investment by defense contractors would produce cost reductions.

49. There is presently a sufficiently large industrial base at the:

- Prime contractor level.
- First tier subcontractor level.
- Lower tier subcontractor level.

50. Within the past five years, there has been a substantial decrease in the size of the industrial base at the:

- Prime contractor level.
- First tier subcontractor level.
- Lower tier subcontractor level.

51. The present capital employed factor (16-20%) is too small to provide a tangible incentive for investment.

52. The flow down of capital investment incentive provisions to subcontractors would result in lower prices to the Government.

53. Significant cost savings could be realized on defense contracts through methods other than capital investment.

54. There are currently sufficient tools available to reward a contractor for cost savings which are generated by methods other than capital investment.

For each of the following changes, indicate how much of an effect would result. Use the scale below and write your response number in the blank space provided next to each item.

1	2	3	4	5
Large Decrease	Marginal Decrease	No Effect	Marginal Increase	Large Increase

55. What effect would each of the following changes have on contractor facilities capital investment?

- a) \_\_\_\_\_ Increasing profits.
- b) \_\_\_\_\_ Increasing financing.
- c) \_\_\_\_\_ Increasing program stability.
- d) \_\_\_\_\_ Increasing competition.
- e) \_\_\_\_\_ Increasing depreciation allowances.
- f) \_\_\_\_\_ Increasing the relative importance of facilities capital employed within the WGL.

For each of the following technical areas, indicate how often you refer to the FAR or DoD regulations. Use the scale below and write your response number in the blank space provided next to each item.

1	2	3	4	5
Never	Seldom	Sometimes	Often	Always

56. How often do you refer to:

- a) \_\_\_\_\_ Pricing policy and practices.
- b) \_\_\_\_\_ Cost Accounting Standard 414.
- c) \_\_\_\_\_ Profit policy and practices.
- d) \_\_\_\_\_ Weighted guidelines.
- e) \_\_\_\_\_ Contract financing policy and practices.
- f) \_\_\_\_\_ The flexible progress payment model.

THANK YOU FOR COMPLETING THIS QUESTIONNAIRE.  
PLEASE SEAL IT IN THE RETURN ENVELOPE PROVIDED AND MAIL IT TO DMDC.

**COMMENTS:** You are encouraged to amplify your responses or make general remarks by making written comments on this page. Please relate your comments to the item in the questionnaire by providing the question number to which it refers.

**SUPPLEMENTAL SURVEY QUESTION:** At the 30 May 1984 Defense Financial and Investment Review Steering Committee meeting many of the members expressed interest in understanding how you treat risk reduction provisions (such as economic price adjustments clauses, capital indemnification clauses and increased progress payment levels) when you establish your pre-negotiation profit objective. Does the existence of these provisions influence you to offer lower profits than you would if they were not included? Do you believe they are helpful in achieving lower profits and/or prices for the government? If you have a firm opinion on this issue, please provide your comments in the space provided below.

**APPENDIX B**  
**RESPONSES TO SURVEY QUESTIONNAIRE ITEMS**

## RESPONSES TO QUESTIONNAIRE ITEMS

## SECTION II - PRICING

<u>Item Number</u>	<u>N</u>	<u>Percentage</u>				
		<u>Strongly Disagree</u>	<u>Disagree</u>	<u>Neither Agree Nor Disagree</u>	<u>Agree</u>	<u>Strongly Agree</u>
8a	(766)	5	22	37	33	2
8b	(769)	9	38	28	23	1
8c	(770)	4	28	41	26	1
8d	(771)	12	41	18	25	4
8e	(764)	15	32	30	22	2
9a	(773)	6	24	10	53	8
9b	(764)	4	24	23	43	5
9c	(764)	8	32	23	34	3
10a	(771)	0	1	2	55	41
10b	(770)	1	8	9	56	27
10c	(770)	1	2	6	58	33
11	(765)	6	40	18	29	8
12	(775)	20	41	6	26	7
13	(757)	3	9	29	39	20
14	(767)	7	26	22	34	11
15a	(741)	2	19	26	41	12
15b	(734)	12	42	32	13	1
15c	(733)	17	34	20	24	4
15d	(735)	5	30	19	30	16
16a	(767)	2	21	11	59	7
16b	(762)	13	38	14	34	2
16c	(762)	10	36	17	34	4
16d	(764)	3	12	21	52	13

**RESPONSES TO QUESTIONNAIRE ITEMS**

**SECTION III - PROFIT**

<u>Item Number</u>	<u>N</u>	<u>Percentage</u>				
		<u>Strongly Disagree</u>	<u>Disagree</u>	<u>Neither Agree Nor Disagree</u>	<u>Agree</u>	<u>Strongly Agree</u>
17a	(752)	5	29	38	27	1
17b	(754)	6	44	28	21	1
17c	(752)	4	36	42	17	1
17d	(757)	9	46	25	17	2
17e	(752)	10	40	34	15	1
18a	(761)	3	23	25	47	2
18b	(753)	6	37	25	31	1
18c	(753)	6	37	24	31	2
19	(755)	1	14	24	41	20
20a	(762)	10	39	25	24	2
20b	(755)	14	36	24	22	3
21	(772)	3	21	12	50	14
22	(775)	2	12	11	50	25
23	(765)	17	42	17	22	3
24	(753)	1	6	24	53	16
25a	(753)	4	35	29	30	2
25b	(749)	3	22	21	44	11
25c	(750)	2	18	29	42	10
26	(763)	5	44	20	27	5
27	(762)	5	36	28	26	4
28	(747)	1	17	40	38	4
29a	(740)	2	11	35	46	5
29b	(736)	4	17	42	34	4

**RESPONSES TO QUESTIONNAIRE ITEMS**  
**SECTION III - PROFIT (CONTINUED)**

Item Number	N	Percentage				
		Strongly Disagree		Neither Agree Nor Disagree	Agree	Strongly Agree
		Disagree	Agree			
30a	(763)	5	33	12	40	10
30b	(758)	3	33	20	39	4
30c	(759)	3	30	19	45	3
30d	(760)	2	22	39	31	6
30e	(759)	9	38	30	14	9
30f	(760)	7	28	17	36	13
31	(751)	4	39	20	32	5
32	(769)	1	3	5	56	35
33a	(735)	10	38	30	21	1
33b	(736)	2	16	31	41	10
34	(769)	4	29	12	41	14
35	(761)	7	58	29	6	1
36a	(757)	4	28	26	38	5
36b	(752)	1	11	17	62	10
37	(745)	10	42	22	24	3

**RESPONSES TO QUESTIONNAIRE ITEMS**  
**SECTION IV - CONTRACT FINANCING**

<u>Item Number</u>	<u>N</u>	<u>Percentage</u>					
		<u>Strongly Disagree</u>	<u>Disagree</u>	<u>Neither Agree Nor Disagree</u>	<u>Agree</u>	<u>Strongly Agree</u>	
38a	(731)	3	17	36	41	3	
38b	(735)	5	40	36	18	0	
38c	(731)	4	36	45	15	0	
38d	(733)	7	43	33	16	1	
38e	(726)	8	43	32	17	1	
39a	(723)	4	32	34	29	0	
39b	(721)	5	36	32	27	0	
39c	(717)	6	37	35	22	0	
40a	(713)	1	23	31	36	8	
40b	(709)	1	22	44	28	5	
40c	(709)	1	10	34	47	8	
40d	(711)	4	26	44	25	1	
41a	(728)	2	30	43	21	3	
41b	(724)	5	41	46	7	1	
41c	(723)	4	30	29	34	3	
41d	(713)	10	53	23	12	2	
41e	(715)	6	37	30	24	3	
41f	(727)	2	18	13	57	9	
41g	(724)	26	57	13	2	1	
42	(732)	4	31	23	38	3	
43a	(732)	13	52	22	13	1	
43b	(736)	7	24	12	50	6	
43c	(731)	6	27	31	34	3	
44	(728)	4	30	40	25	1	
45	(716)	3	38	44	15	1	

## RESPONSES TO QUESTIONNAIRE ITEMS

## SECTION V - INVESTMENT INCENTIVE

Item Number	N	Percentage				
		Strongly Disagree	Disagree	Neither Agree Nor Disagree	Agree	Strongly Agree
46a	(692)	4	28	41	26	1
46b	(697)	4	40	41	15	0
46c	(694)	4	37	47	13	0
46d	(695)	7	45	38	9	0
46e	(694)	6	31	37	24	1
47a	(685)	4	32	39	25	1
47b	(684)	4	29	44	23	1
47c	(682)	4	29	45	22	0
48	(721)	2	16	24	46	12
49a	(709)	3	23	23	47	4
49b	(701)	3	27	33	36	1
49c	(699)	6	28	38	26	2
50a	(691)	3	34	41	20	2
50b	(687)	2	27	44	25	2
50c	(684)	2	19	45	29	5
51	(703)	5	32	39	23	2
52	(703)	3	22	41	34	1
53	(703)	1	4	37	50	8
54	(707)	3	29	25	40	3

**RESPONSES TO QUESTIONNAIRE ITEMS**  
**SECTION V - INVESTMENT INCENTIVE (CONTINUED)**

<u>Item Number</u>	<u>N</u>	<u>Percentage</u>				
		<u>Large Decrease</u>	<u>Marginal Decrease</u>	<u>No Effect</u>	<u>Marginal Increase</u>	<u>Large Increase</u>
55a	(705)	0	2	34	53	11
55b	(707)	0	5	38	49	7
55c	(703)	0	1	19	33	47
55d	(702)	3	18	28	32	19
55e	(694)	1	2	18	57	23
55f	(700)	0	1	46	46	7

		<u>Percentage</u>				
		<u>Never</u>	<u>Seldom</u>	<u>Sometimes</u>	<u>Often</u>	<u>Always</u>
56a	(758)	1	13	34	42	9
56b	(759)	10	37	34	14	6
56c	(757)	2	13	35	40	9
56d	(759)	1	11	26	43	19
56e	(756)	6	28	38	24	5
56f	(755)	16	36	29	14	5

**END**

**FILMED**

**10-85**

**DTIC**